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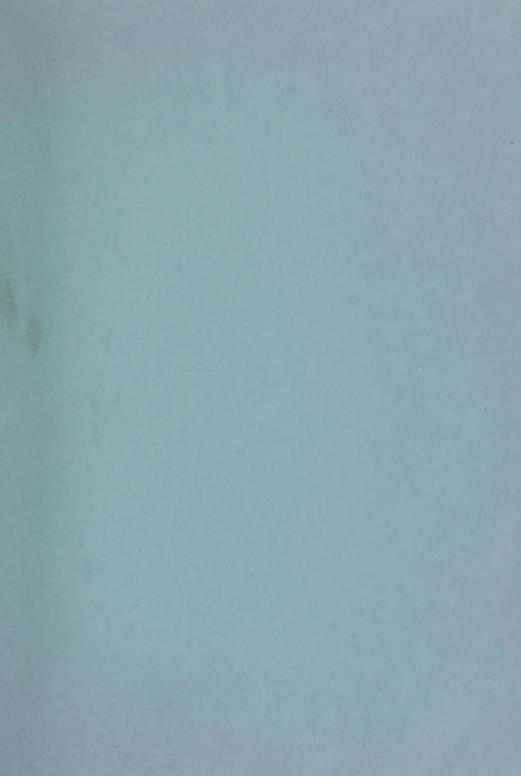
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22122

(V.3463)

RILEY LEON HUGHES

Plaintiff- Appellant)

v.

J HERMAN GENGLER *

Defendant Appellee

CIVIL No 9851

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE

EASTERN DISTRICT OF CALIFORNIA

BRIEF FOR APPELLANT

Prepared for the use of: -

THE UNITED STATES COURT OF APPEALS, NINTH CIRCUT COURT AT SAN FRANCISCO, CALIFORNIA.

BV

Rilay Leon Hughes Thes

Appointing myself in Propria Persona as my attorney. TITLE 28 Sec. 2678 ATTORNEY FEES; Penality- limiting fees to 25% of judgement, precludes plaintiff from hiring an attorney.

Note:

Defendants should include THE UNITED STATES

POST OFFICE and John Does; see argument in REVIEW OF THE SIGNIFICANT FACTS OF THE RECORD OF THE ABOVE CASE...AND A

BRIEF HISTORY OF THE CASE, page 7 line 15.

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Title page

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	NOTICE OF APP	EAL	June, 27,	1967
	PETITION FOR HEARING ON MOTION FOR APPEAL AND THAT			

"PETITION FOR NEW TRIAL", BE CONSIDERED A SUPPORTING BRIEF FOR ABOVE ACTION. July 26, 1967. (List is not complete.)

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CITATIONS

CASES:

AMERICAT OIL SERVICE, INC. v. HORE OIL CO.

233 Cal. Lpp. 2d 822.

Payments made under mistake recovered.

Used in- ANSWER TO LEMNOR WIDLEN AND CROER of May 1967

Page 6 line 16.

- NOTICE OF AFTERL

Fage 4 line 27

CHRISTIAN BEACON V. UNITED STATES

C. A. N. J. 322 F2d 512

"Federal Courts have jurisdiction ... "

Used in- PETITION FOR NEW TRIAL page 3 line 22.

159 Cal 142, S.F. No. 5227 Jan, 4, 1944.
Payment made due to mistake recovered.

REVIEW OF SIGNIFICANT PARTS... BRIEF HISTORY...

See use of case in REVIEW Page 14 line 26.

In ANS. TO MEMO & ORDER Page 7 line 12.

Used in MOTICE OF AFTUAL Page 5 line 9.

CLAUS H HENNINGTON AND HELEN HENNINGSEN v. BLOOMFIELD MOTORS, INC., AND CHRYSLIR CORF.

161 A2d 69 1960 (Atlantic Reporter)

"The gross inequality of barganing position ...

The task of the judiciary..." A parallel case decided in favor of an ordinary man

Used in AMS. TO MEM & ORDER May '65 pg. 2 line 32.



OA MEG (Jont.)

MATTESON v. UNITED STATES 340 F2d 517, 318-319 (: d-Memorandum and Order combining judgement caused / misunderstanding of appeal time limit. (- Cir 1903)

Used in, - PETATION FOR MANY TRIAL page 3 line 10

TEAL v. FELTON, 90 U.S. N.Y. 12 Howard. 289, 13L Ed 990. Recovered cost of Newspaper withheld by postmaster from P. O. Box.

Used:, NOTICE OF APPEAL page 6 line 10

PETITION FOR NEW TRIAL page 2 line 9

THIS BRIEF page 11 line 9

19 line 19

PURE OIL CO, v. TUCKER 164 F2d 945

Restitution for over payments made.

Used: NOTICE OF APPEAL page 4 line 26

STATUTES

UNITED STATES SUPREME COURT DIGEST 1987 Cultulative Supplement to volume 17 of Court Rules - Rule 88.

Used: - PETITION FOR NEW TRIAL page 3 line 1

TITLE 18 U.S.CODE Sec. 1701 - 1703

Used; - NOTICE OF APPEAL page 1 line 17 page 3 line 7

TITLE 28 U.S.CODE Sec. 171

Used: - ANS FOR PTS. AUTHORITIES Apr. 19, 1967

Revised reference for page 6 line 20



TITLE 28 U.S. CODE Sec. 171 (Cont.)

Used: - REVIEW OF SIGNIFICANT PARTS. . . PRISE HIST.

Page 6 line 18

TITLE 39 U.S.CODE Sec 2101 (Nor Sec. 501 see below)*

Used: - REVIEW PTS... HISTORY Page 4 line 23

TITLE 39 U.S. CODE Sec. 2302

Used: - NOTICE OF AFFELL Fage 7 line 23

TITLE 39 U.S.CODE SEC. 2409

Used: - REVIEW FIE... HISTORY Page 6 line 16

TITLE 39 U.S. CODE Sec. 3523

Used: - NOTICE OF APPEAL Fage 1 line 20

TITLE 39 U.S. CODE Sec 4055

Used: - NOTICE OF APPEAL Page 5 line 6

TITLE 39 U.S.CODE Secs. 6006 - 6007

Used:- AMS. TO MEMO AND ORDER, Fg. 1 line 21

Pg. 2 line 10

REVIEW PTS. HISTORY Page 11 line 3

NOTICE OF AFPEAL Page 1 line 20

TITLE 39 U.S. CODE Sec. 501

Used: - REVIEW PTS... HISTORY Page 5 line 16

POSTAL MANUAL

PART 115 COMPLAINTS (See also PART 313)

Used: - Notice of Appeal Page 3 line 11



POSTAL MARWAL (Cont.)

PART 147 PAYMENTS AND REFUNDS (Use for Part 34) Used: - ANS. FOR PTS. AUTHORITIES PA. 3 line 8 NOTICE OF AFSEAL Page 7 line 11 REVIEW PTS. HISTORY Page 7 line 7 PART 166. SPECIAL DELIVERY (see 354 Spec. Deliv. Serv.) Use for \$56.* in ANS. FOR PTS. AND AUTHORITIES Page 2 line 15 Used: - REVIEW PTS. HISTORY Fame 7 line 6 NOTICE OF APPEAL Page 2 line 6 PART 313 CUSTOMER COMPLAINTS Used: - NOTICE OF APPEAL Page 3 line 12 PART 335 POSTAGE DUE MAIL (Use to replace TIME VI Used: AMS. FOR PTS. AUTHORITIES Pa. 5 line 14 REVIEW PTS. HISTORY Page 4 line 4 PART 354 SPECIAL DELIVERY SERVICE (See also Sec. 163) Used: - AMS. FOR PTS. AUTHORITIES Fg. 2 line 15 Page 3 line 20 NOTICE OF APPEAL PIRT 452.8 and 852 Page 7 line 4 See REVIEW PTS. HISTORY PART 742 CODE OF COMDUCT

*Note:

Given TITIM 39 Chapter 1 part 50 in this

document. Except for minor differences Part 160 and 354

together will equal what is quoted. The working POSTAL

Page 7 line 27

NEWAL IS LOCKE LEAF and minor changes are frequent.

Used: - NOTICE OF APPEAL



THE PROPERTY OF THE STREET

- 1. THE AMERICAN RETURLIC by Pater Odequard

 FART IV Chapter 19, "Legal responsibility..pg.488"

 Used in this BRIEF page 8 line 1.

 PART V POWER LAW LIDERTY Chapter 21 page 508

 Used in this BRIEF page 11 line 24.
- E. ARCO COURSE BY ARCO FUBLISHING CO., 480 Lexington Ave. N. Y.

Used in ANS. FOR FTS. AUTHORITIES page 4 line 26.

- 3. CORPUS JURIS SECUNDUM Postoffice &

 (II P.O. DEPT. P.O.s., P.M. and other officers.)
 - a. In general --- By statute U.S.C.A. § 361 has power to promulgate postal regulations which are controlling and have the force of law, subject to the limitations that the regulations must not be inconsistent with the postal act and that they do not treach on legislative power, but are designed and purport only to be administrative in character. -- Used:- this BRIAL pg. 18 ln. 23.
- 4. READER'S DIGEST ANNUAC 1967 page 443

 Used:- This BRIEF Page 12 line 11



JURIODIC DIONIL BYTHE BELT

California. This case is the result of the above postar stor refusing to accept a protest ande by the plaintiff in regard to services and postal charges made at the Abryaville postoffice. This case was originally filed in the SALL CLIP'S COURT, COUNTY OF YUB1, STITE OF CALIBORUA. As the defense chose not to recognize the plaintiffs claim for reimbursement of overcharges, and alleged that the post-master was, - "(Acting) within his official discretion under color of such office", - action was taken by the defense to move the case to the U.S. District Court at Ascramento, California, by authority of Title 28 Sec. 1446.

The plaintiff accepted the change of jurisdiction on the assumption that an equitable decision would be made based on all of the facts presented. However the Appeals Court may find upon reviewing the case, that the government attorneys were in error, in not recommending that the plaintiff be reimbursed for his overcharge, and that they should have let the postmaster defend himself, in the lower court, since the postmaster was not acting under any Postal or Government order, in choosing not to accept the legitimate complaint of the plaintiff. See TEAL v FELTON, 13 law Ed.

90. Discussed in MOTICE OF APPEAL page & lines 10 through 28 and page 7, lines 1 through 24.



In The American Republic by Peter H. Odegard, Part 1V, THE STRUCTURE OF POWER Chapter 19, The Federal Bureaucracy, page 435 top right, "Legal responsibility has been enforced through the ordinary courts, and liability for wrongful acts by civil servants has attached to the individual and not to the state."

As the case now stands, the plaintiff must choose to appeal to the Court of Appeals for relief.

JUESTIONS PREJERTED

- l. Whether the postmaster, "(Acting) within his official discretion and color of such office", has the right to ignore postal regulations.
- 2. Whether the plaintiff has the right to expect reimbursement for charges collected in error for services not rendered.
- 5. Whether a postmaster not acting under Fostal or Sovernment regulations is immune from tort action when such personal, ministerial action damages the rights of a postal patron.
- 4. Whether a postmaster can annul a postal patron's right to make a complaint of petition.
- 5. Whether the court erred in ruling against question to (2) above, and not considering the other questions.
- 6. Whether the court erred in not granting plaintiff egal aid and whether the government is a party to the case.



STATEMENT OF FICTS

The reproduction of the letter shown below, exhibits the facts. It was received at the post office on May 30, 1966 a holiday, and would have been received by the plain—tiff on that day if it had been placed in his post office box. It was withheld for alleged postage deficiency regardless of the fact, that no outside address was on file at the postoffice to make special delivery service possible.

The 3¢ stamp, canceled but undated represents the alleged deficiency.

The plaintiff took time off from work to enquire about





the mail shortly before the postoffice's closing time about June 2nd, 1966. The postal clerk refused delivery of the letter until he had taken 30 from the delivery.

When the plaintiff telephoned the postmaster to protest the following day, the postmaster declined to decept the protest. See REVIEW OF THE SIGNIFICANT TALKS OF THE RECORD ... AND A BRIEF HISTORY OF THE CATE, pages 1 2. and 3 for more details of facts.

Mote:

This is not an isolated case. I have a letter from a soldier's wife, in which she mentions having to drive into Marysville for her special delivery letters although she lives within two (200) hundred feet of the postman's rural route.

SUMMARY OF ARGUMENT

It is the argument of the plaintiff that rules in the Postal Manual are adequate to govern in this case

- 1. POSTAL MANUAL, Part 355 Special Delivery Service, sub part 354.7 PAYMENTS FOR DELIVERY, FEE BASIS 554.722.

 Do not pay a fee when: a. Special Delivery Service is not rendered or attempted, b. Delivery is made through post office window or box....
- 2. Part 147 PREDAYMENT AND RETUNDS, sub part 147.2 Refunds, 147.23 (mount of refund available, 147.231



Refunds of 100% will be tade: 8. When the postal service is at fault.... f. When fees are paid for apecial delivery, special handling, and certified sail and the article fails to receive the special service for which fee has been paid.

- 3. PART 313 CUSTOMER COMPLAINTS 513.2, ORAL OCCUPANNTS, 313.21. Employees must make a memorandum in writing on Form 1835, Record of call or visit, of all complaints received orally either in person or by telephone.
- 4. A postmaster is not immume from court action unless he is acting under an existing postal regulation. Jee TANL v. FELTON, 12 Howard (284 US), 13 LAW. Ed. 990, 40 c P.O. § 11.22. See NOTICE OF APPIAL page 6, lines 10 27, page 7 lines 1 to 24.
- 5. Sums paid as the result of errors are recoverable.

 See AMERICAN CIL SERVICE vs. HOPE CIL COMPANY 233 Cal. App
 2d 822 and HANNAH vs. Williams (S.F. No. 5227 Jan. 4, 1944.

 See plaintiff's REVIEW OF THE SIGNIFICANT FACTS... APD A

 BRILF HISTORY OF THE CASE, page 13, lines 16-27 and through
 pages 14 and 15 to line 13 on page 16.
- 6. The NOTICE OF AFFEAL, by the defendant should be considered to be an argument supplementing this brief.

 Much of its material is copied in the following argument.
- 7. The persistence with which the postmaster was defended in the case TEAL v. FELTON (summarized on page 19), should be noted. Persistence without merit on public purse.



ARGUMENT

In a MEMORANDUM AND ORDER dated may 1, 1967 and sent to the Plaintiff, the Court determined against the Plaintiff's effort to recover the three cents that had been charged against him in error and his costs. The following, quotes lines 19, 20 and 21 of page 2 of the MEMORANDUM AND ORDER, "It is, therefor, ordered that the plaintiff take nothing by this action and that judgement be for the defendant." This decision was affirmed by a JUDGEMENT of the Court dated July 7, 1967.

In arriving at the decision the Court erred, in fitting the following statement to to the case, from same MEMORANDUM as above, 2nd paragraph page 2, "It is elementary law that if a person pays even an illegal demand (This is not to suggest that the demand here is illegal. That question need not be reached.) or pays a demand through ignorance or misapprehension of the law respecting its validity, but not under compulsion or coersion, he cannot recover the money so paid. (See: Pure Oil Co. v. Tucker, 164 F2d 945; American Oil Service Inc. v. Hope Oil Company, 233 Cal. App. 2d 822; Thompson v. Thompson, 218 Cal. App, 2d 804; Holm v Bramwell, 20 Cal. App. 2d 332; and Mc Millan v. O'Brien, 219 Cal. 775).

None of these cases were mentioned or discussed at or prior to the trial. (See plaintiff's STATEMENT OF POINTS (2). However the second case mentioned above, can be interpreted in the plaintiff's favor, because in it, it was determined



that money paid due to error or mistake of feets is recoverable. In HANNAH v. WILLIAMS (see page 11 line 16) it was determined that an advance made by the plaintiff was recoverable because of a mutual mistake with respect to the law.

The Court concluded the paragraph discussed above, lines 16,18 page 2 as follows, "I am of the view that this rule is determinative of this case and that there is no need for me to discuss any of the issues which plaintiff seeks to raise. This avoidance of the issues condones the following offense:

Violation of U. S. Code, TITLE 18, Sec. 1701 and 1703 by post office clerks, for who's conduct the postmaster, (the defendant) is responsible, by authority of U. S. Code Sections 3523, and 6006. - Special Delivery Service (b) -, of TITLE 39, as a result of the clerks in error withholding a personal letter from the post office box of the plaintiff, P. O. Box 651, Marysville, California, on May 30, 1936 a holiday, because of a charge for special delivery service that was not rendered; and leaving instead of the letter in the box, a printed card -- (POD Form 3907) marked MATL WITH POSTAGE DUE. The POSTAL MANUAL Part 166.43 gives instructions that notice be left that special delivery mail is being held. See proper card in exhibits.

POSTAL MANUAL 166.4 DELIVERY PROCEDURES, .41 To Whom Delivery May Be Made. -- Line 3, "At letter-carrier offices, special delivery mail, other than registered and insured,



addressed to a post office box or to the general delivery. is delivered to the box or held for delivery through the general delivery window, unless the addressee has given written notice that such mail be delivered to his residence or place of business." Since the plaintiff had not left any written notice for delivery of any kind of mail to his residence or elsewhere, there was no means by which the plaintiff could have been given special delivery service. Since no fee is paid for delivery of special delivery mail to a post office box (Reference POSTAL MANUAL Part 354.722 a.), and a 100% refund is allowable when payment has been made for such service and such service has not been rendered, (Reference POSTAL MANUAL Part 147.231 (.) the postal clerk should have ignored any postage due note on the letter and have left the letter in the post office box. As this was not done, then a mistake was made by the postal clerk. A mistake was also made when the postal clerk demanded and took from me 3¢, before he would surrender the letter.

This case is quite like the case of: WILLIAM W TEAL,
Plaintiff in Error, v. MARY C. FELTON by her next friend,
Charles T. Hicks. (90 U.S. TEAL v. Felton, N. Y. 12 How.
289, 131 Ed. 990) In this case the postmaster, Teal, at
Syracuse N. Y. 1847, made the mistake of assuming a single
letter on the wrapper of a newspaper to be a message to Mary
C. Felton, the addressee and withheld the newspaper,



elaiming additional funds due for first class mail. The woman's First friend Charles T. Hicks brought suit in her behalf to recover the value of the newspaper, six (64) cents. The postmaster was defended in every court, from that of the justice of the peace for Onodaga County of New York up to and including the Court of Appeals of New York. The verdlet in each court was six (6¢) and costs, final total \$136.19. What was finally said there could be said in this case:

"... The State Court had jurisdiction to try the case. State Courts had jurisdiction over all cases of trover, and the constitution of the United States did not abrogate their jurisdiction in such cases as the present.

Mr. Justice Wayne, "This was not a case in which judgement could be used to determine any fact, except by some other evidence than the letter itself. Nor was it one calling for discretion in the legal acception of that term in respect to officers who are called upon to discharge their duties. What was done by the postmaster, was a mere act of his own, and ministerial, as that is understood to be distinct from judicial. ... It is the law which gives the justification, and nothing less than law can give irresponsibility to the officer, although he maybe acting in good faith under the instructions of his superior of the department to which he belongs. Here the instructions exceed the law, as marks and signs of themselves without some knowledge of their meaning and intention in the use of them, are as we have said, neither memoranda or writings. TRACY v. SWART OUT



10 Pet. 80."

The case just mentioned is concerned about a newspaper that was withheld from a postal patron. This case is concerned with a personal letter. The public has a right to expect to receive unmolested its personal mail by paying the highest rates for mail, as first class mail, and by act of CONGRESS 39 U. S. C. Sec. 2302 DECLARATION OF POLICY, specifically, "(1) that the post office is a public service."

The court erred in taking no step or action to protect such right of the plaintiff.

BASIC STANDARDS OF ETHICAL CONDUCT. From Postal Manual 742.2. (House Concurrent Resolution 175, 85th Congress, 2d session, 72 Stat. Bl2)

"1. Put loyalty to the highest moral principles and to country above loyalty to persons, party or government Dept.

"2. Uphold the Constitution, laws, and legal regulations of the United States and of all governments therein and never be a party to their evasion.

"5. Never discriminate unfairly by dispensing of special favors or privileges to any one,

"10. Uphold these principles ever conscious that public office is a public trust."

CONCLUSION

The subject of decisions is discussed in THE AMERICAN REPUBLIC by Peter H. Odegard under Equal Justice under The Law, page 508, paragraph 3 quoting Judge Bernard Botein,



The difiliting of a frago my become provoder

IN INTRODUCTION TO THE LEAD PRODER, by Perhard V. O talão end others, lert o, T and page 0.0, top, Trae mestion whether the jury acted rationally- that is, whether the verdict is supported by the evidence, and ther reasonable men could reach the jury's verdict on the strength of the admissible and creditible evidence presented- is a question of law to be decided by the judge." To arrive at s verdict without a jury, should not a judge still consider how reasonable men, jurors, would consider the facts? The Reader's Digest Almondo for 1967 page 443, gives the income of the average family as \$6,880, 16% had incomes under 43,000. Reasonable men at average income could not afford to feel indifferent, to the use of the special delivery service, by those to whom long distance telephone bills are a costly luxury.

The decision of the district court suggests feelings of class preference inconsistent with present legal and social thinking. It is inconsistent with postal regulations and the cases quoted in this brief and other documents presented by the plaintiff.

By argument here presented the plaintiff concludes:

1. Postal regulations have the force of law (see CORFUL TURIN SECURDAN reference No. 3 this BRID? are 6) and should be so observed by the postanster.



- 2. The of intiff has the right to resover prymone in sector services not rendered.
- Tostal laws the postmuster becomes dersomably responsible for the consequences of such mets and era chair, no immunity as a deverament officer or postal engloyee.
- 4. The right to make a reasonable complaint or potition is a fundamental right enjoyed by all citizens and may not be set aside by a postmaster.
 - 5. The plaintiff is entitled to his reasonable costs.

Riley Local Tragles
Riley mon humes
Pleintift.

Note:

Exhibits were introduced at the trial at the begining of the testimony. The proper type of notice to be left in a post office box to indicate special delivery mail was being withheld, was introduced by the plaintiff's wife, Mrs Mary Cay Hughes. The exhibits shown on page 9 were introduced by the plaintiff.

The exhibits introduced by Mrs Hughes were obtained by her at the Yuba City post office.

Plaintiff has made payment for the cost of making three copies of the record, and reserves the right to refer to any part thereof.



IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

RILEY LEON HUGHES,

Appellant,

vs.

J. HERMAN GENGLER,

Appellee.

NO. 22122

BRIEF FOR APPELLEE

JOHN P. HYLAND United States Attorney

WILLIAM B. SHUBB Assistant U. S. Attorney

Attorneys for Appellee J. Herman Gengler

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STATUTES AND OTHER AUTHORITIES

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IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CTRCUTT

Appellant, NO. 22122

vs.

J. HERMAN GENGLER, BRIEF FOR APPELLEE

Appellee.

JURISDICTION

This action was originally filed in the Small Claims

Court for the Marysville Judicial District, County of Yuba,

State of California, to recover from the Postmaster of the

United States Post Office at Marysville, California, for the

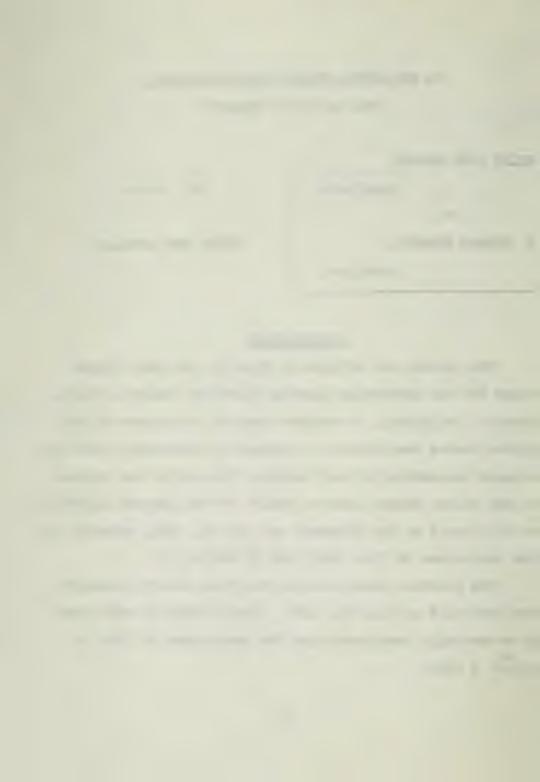
alleged mishandling of mail matter. The action was removed

to the United States District Court for the Eastern District

of California by the defendant on June 23, 1966, pursuant to

the provisions of Title 28 U.S.C. § 1442(a)(1).

The District Court entered its final decision against the plaintiff on July 18, 1967. Jurisdiction of this Court is accordingly predicated upon the provisions of Title 28 U.S.C. § 1291.



STATEMENT OF THE FACTS

After hearing and receiving all of the appellant's evidence in plenary trial, the District Court found the following facts:

- Defendant is Postmaster of the United States Post Office at Marysville, California, and was at all times involved herein acting under color of such office.
- 2. A letter arrived at the Marysville Post Office addressed to the plaintiff on or about May 31, 1966.
- 3. An employee of the Post Office determined that there was three cents postage due on said letter and made that fact known to the plaintiff.
- 4. Plaintiff paid the three cents "under protest."
- 5. Plaintiff was not in any way coerced into paying the said three cents, but rather had the clear choice himself whether to pay or not to pay the said amount allegedly due.1

ARGUMENT

The District Court found that appellant, having the clear choice whether or not to pay the three cents allegedly due on the special delivery letter, and not acting under any

^{1/} The District Court's Findings of Fact, filed July 18, 1967. See also Memorandum and Order of the District Court, filed May 1, 1967.



coercion whatsoever, chose to pay the three cents. By this action, appellant seeks to recover the amount so paid, plus costs and expenses which he seeks to attach.

As the District Court pointed out in its Memorandum and Order:

"It is elementary law that if a person pays even an illegal demand . . . or pays a demand through ignorance or misapprehension of law respecting its validity, but not under compulsion or coercion, he cannot recover the money so paid (See: Pure Oil Co. v. Tucker, 164 F.2d 945; American Oil Service Inc. v. Hope Oil Company, 233 Cal. App. 2d 822; Thompson v. Thompson, 218 Cal. App. 2d 804; Holm v. Bramwell, 20 Cal. App. 2d 332; and McMillan v. O'Brien, 219 Cal. 775)."

Thus, the District Court concluded, we submit correctly, that appellant was entitled to no relief. The Court accordingly did not reach the question of whether the demand was legal or illegal.

The instant case is thus readily distinguishable on this fact alone from <u>Teal v. Felton</u>, 53 U.S. 284 (1851), upon which appellant seeks to rely, since in that case the plaintiff had refused to pay the postage due.

This was not a case involving mutual mistake of fact (Compare <u>Hannah v. Steinman</u>, 159 Cal. 142 (1911)) as contended by appellant. There is no finding, nor was there



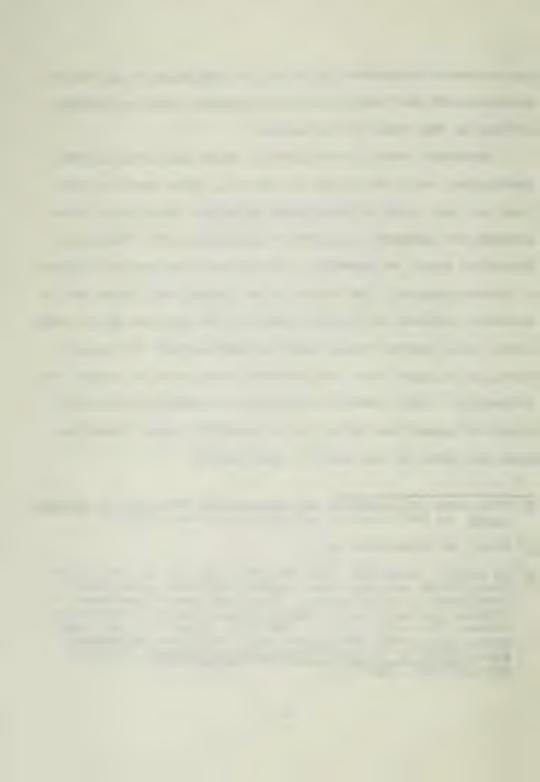
any evidence whatsoever, that either appellant or any representative of the Post Office was laboring under any mistake of fact at the time of the payment.

Moreover, even if the District Court had erred in its conclusion, which we submit it did not, there were no findings nor was there evidence upon which the Court could have entered any judgment in favor of the plaintiff. The sole defendant named or served in the action below was Postmaster J. Herman Gengler. Yet there is no finding and there was no evidence whatever at trial of any act or omission on his part which could possibly give rise to liability. 2/ On appeal, appellant alleges that the Postmaster declined to accept his protest. 3/ This, however, according to appellant's allegations on appeal, was after the allegedly illegal demand was made and after it was paid by appellant. 4/

^{2/} This case is therefore distinguishable from Teal v. Felton, supra, on this fact as well as that noted above.

^{3/} Brief for Appellant, p. 10

On appeal, appellant also asserts that the United States Post Office and John Does should have been included as defendants to this action. The Court would have been without jurisdiction to enter judgment against the United States (Title 28 U.S.C. § 2680(b)), even if it had been named and served, or against any fictitious defendants (See Molnar v. National Broadcasting Company, 213 F.2d 684 (9th Cir. 1956)).



CONCLUSION

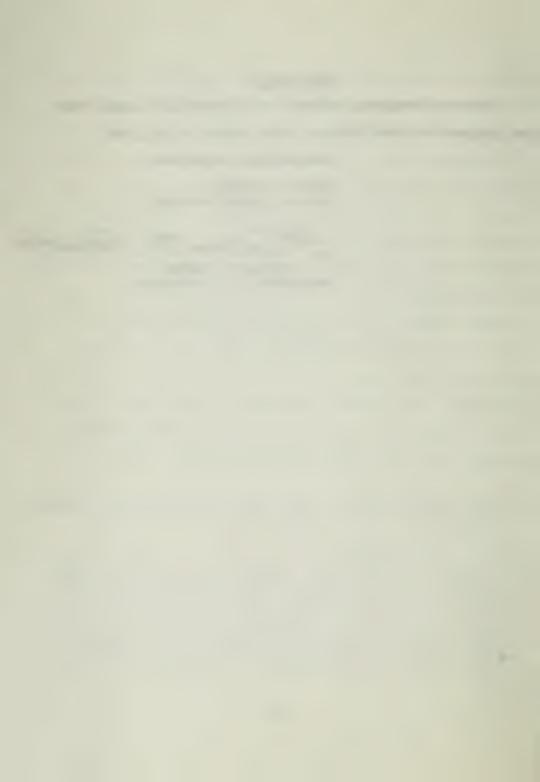
For the foregoing reasons, we respectfully submit that the judgment of the District Court should be affirmed.

Respectfully submitted,

JOHN P. HYLAND United States Attorney

By William B. SHUBB

Assistant U. S. Attorney

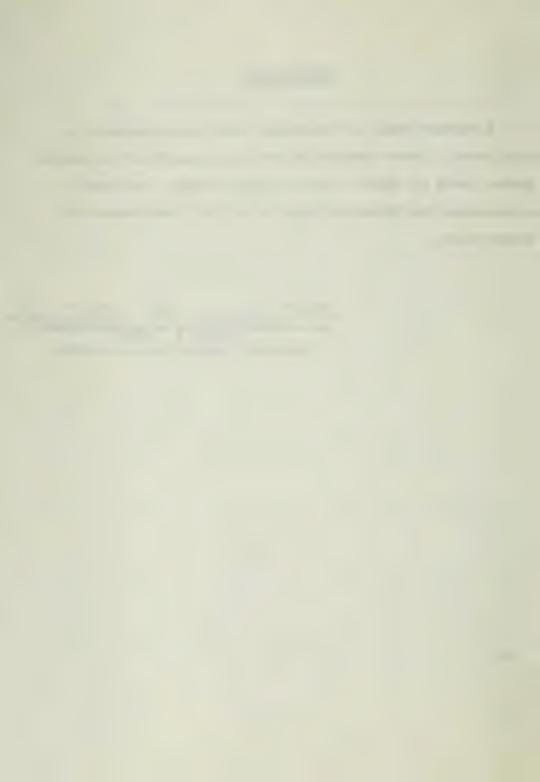


CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

WILLIAM B. SHUBB

Assistant United States Attorney



CERTIFICATE OF MAILING

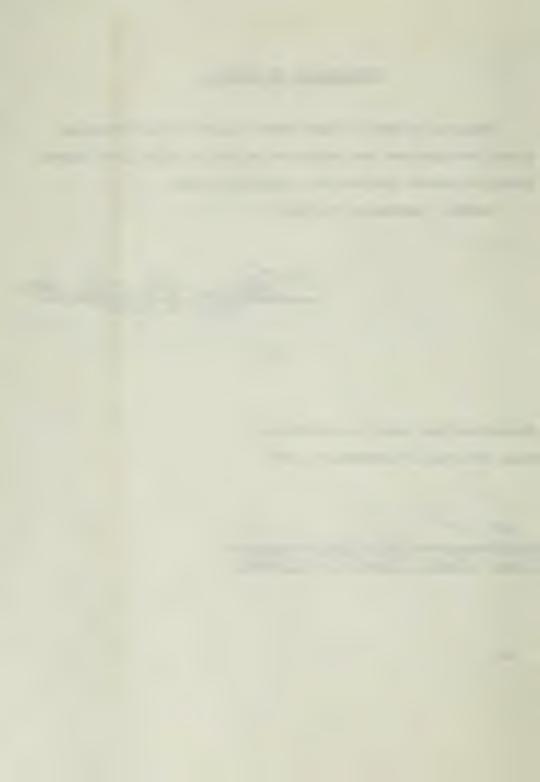
This is to certify that three copies of the foregoing Brief for Appellee was this date mailed to Riley Leon Hughes, 1608 Elm Street, Marysville, California 95901.

DATED: September 14, 1967

MILLIAM B. SHUBB

Subscribed and sworn to before me this 14th day of September, 1967.

DEFUTY CLERK, UNITED STATES DISTRICT COURT, EASTERN DISTRICT OF CALIFORNIA



IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUT

Appellant,
vs.
HERMAN GENGLER,

Appellee.

NO. 22122

ANSWER TO BRIEF FOR APPELLEE

EILED

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M. B. LUCK, CLERK

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RILEY LEON HUGHES



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IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUT

LEY LEON HUGHES,

Appellant,

NO. 22122

VS.

ANSWER TO BRIEF FOR APPELLEE

HERMAN GENGLER.

APPELLEE.

JURISDICTION

There is at present, agreement, between appellant and appele as noted in the opening BRIEFS, that the UNITED STATES COURT APPEALS FOR THE NINTH CIRCUT has jurisdiction to judge the posing arguments.

STATEMENT OF FACTS OF APPELLEE ANALYZED AND REBUFFED

- No. 1 "Color of office", is mentioned. The "color" or spect inspired for an office is earned by the holder of such fice through unselfish devotion to the duties of such office giving public service. Arrogant disreguard for the rules d regulations attached to such office, gives an off color to sch office.
- No. 2 The letter is stamped Marysville May 30, 6 A.M. 66. The May 31, 1966 date is incorrect.



- No. 3 The employee made the observation that the letter as stamped, Deficiency 3 cents. His determination that twas due and payable was in error.
- No. 4 Plaintiff sought to convince the clerk of his rror in his declaration, "I certainly am not getting SPECIAL ELIVERY SERVICE." The three (3¢) cents paid was to ransome personal distress message.
- No. 5 The clerk refused the delivery of what was evicusly a distress message until he had taken the three (3¢) ents from me. This was coercion. If the letter had not sen held up, I could have sent the sister who wrote the etter, money for transportation, so that she could be with ar younger sister in her hours of suffering.

ANSWER TO ARGUMENT OF APPELLEE

The postmaster and the postal employees are guided in their conduct by the POSTAL MANUAL, and statutes passed y the Congress, particularly under TITLES 18, 28, and 39, and not by case law except as the above documents are interreted by the courts.

The District Court and the defence are in error in eeking to judge this case by other than statutes passed by the Congress and postal regulations sanctioned by the Congress. See reference 3, page 6 of BRIEF FOR APPELLANT.) However an quitable interpretation of such cases would be for the rgument of the plaintiff.



The attorney for the defence seeks to convey the mpression that the refusal to "pay the postage due" was terminant in the decision of the case TEAL v. FELTON, page aree (3) of BRIEF OF APPELLEE. All of the Courts held that the postage due" was an illegal charge. Paying the charge all not make it legal or irrecoverable. Other newspapers all be available upon the open market without charge for rst class postage being attached. The suit was for the st of one copy. There was no other copy of my sister's tter available. It was not an article of commerce.

In answer to the argument in appellee's Brief, last ragraph of page 3 and top of page 4, the plaintiff's gument is, that since the postal clerks acted in violation the proceedings required by the POSTAL MANUAL, as described BRIEF OF APPELLANT page 13 last paragraph, positive idence is given that the clerks were in error and therefor e postmaster was in error in upholding such violation.

A review of the first two cases in the appellee's IEF discloses that money paid under mistake was recovered appeal in AMERICAN OIL CO. INC. v. HOPE OIL CO., and in NNAH v. STEINMAN money paid was recovered due to a mutual stake with respect to the law.

In HOLM v. BRAMWELL the contractor Holm lost the money used to hire unlicensed contractors because, to have forced amwell to reimburse the contractor would have condoned an



aprofessional act. The plaintiff's argument in this case sont similarly compromised.

In McMILLAN v. O'BRIEN, O'Brien sought to obtain property of belonging to him by paying taxes on it. When his effort filed he sought to recover the taxes from the owner. As here is no question as the plaintiff's right to the letter, he cases are not comparable.

In MOLNAR v. NATIONAL BROADCASTING CO. 231 F2d 684, ention is made that the FEDERAL COURTS do not allow the eactice of California courts permitting of the use of John es. If the plaintiff wishes to take action against the erk he may take separate action against him.

In PURE OIL CO. v. TUCKER, Tucker, who was in debt to
e PURE OIL CO., lost on appeal his effort to force the oil
mpany to give to him savings that might have been made had
e oil company transported gasoline by way of a pipe line
which, lesser rates comparable to railway rates had become
ailable. Tucker's action was a speculative business
nture, in search of profit. He was already getting gasoline
better rates than he could get at other jobbers. Performance
d not rates are an issue in this case, and this case does not
al with a product sold for profit. See "FINDINGS OF THE
NGRESS 2301 of TITLE 39, (5)-- While the Postal establishent, as all other Government agencies, should be operated
an efficient manner, it clearly is not a business entertise operated for profit or for the raising of funds.--- "



See Appellants MEMORANDA STATEMENT OF FACTS STIPULATIONS POINTS OF LAW page 2, begining with line 5.

The last case mentioned in the BRIEF FOR APPELLEE. THOMPSON v. THOMPSON: Mrs Lois Jaunita Thompson did not act upon advice that . - she get an attormey. The appellant asked that the government provide an attorney for him, as it is the appellant who is attempting to see that the laws of the Congress and the post office be upheld.

"Where Congress, in the proper and prudent exercise of its authority, has spoken, the Court of Appeals is bound. U.S. v. ONE 1950 BUICK SEDAN, C. A. Pa. 1956, 231 F2d 219"

(This reference was taken from U. S. Code Annotated. By West Publishing Co. under TITLE 28 \$ 1291 page 254 3rd paragraph from the bottom right.)

CONCLUSION

For the foregoing reasons and for the protection of patrons of the postoffice, the appellant respectfully submits that the judgement of the DISTRICT COURT be reversed and a decision be made in keeping with the points in the conclusion of his BRIEF. (See BRIEF FOR APPELLANT begining at the bottom of page 17.)

Respectfully submitted,

Riley Leon Hughes

Acting in propria persona

as my attorney



Inited States Court of Appeals For the Ninth Circuit

Ski Pole Specialists, Inc., a corporation, Plaintiff-Appellant,

vs.

Robert J. McDonald, Defendant-Appellee.

APPEAL FROM UNITED STATES DISTRICT COURT
DISTRICT OF IDAHO

APPELLANT'S OPENING BRIEF

RICHARD W. SEED SEED, BERRY & DOWREY

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United States Court of Appeals For the Ninth Circuit

Ski Pole Specialists, Inc., a corporation, Plaintiff-Appellant,

vs.

ROBERT J. McDonald, Defendant-Appellee.

APPEAL FROM UNITED STATES DISTRICT COURT
DISTRICT OF IDAHO

APPELLANT'S OPENING BRIEF

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United States Court of Appeals For the Ninth Circuit

SKI POLE SPECIALISTS, INC.,
a corporation, Plaintiff,-Appellant,

vs.

ROBERT J. McDonald,
Defendant-Appellee.

APPEAL FROM UNITED STATES DISTRICT COURT DISTRICT OF IDAHO

APPELLANT'S OPENING BRIEF

I JURISDICTION

This action was instituted by plaintiff for a declaratory judgment declaring invalid Letters Patent issued to defendant. Plaintiff's Complaint (R-6) was brought under the Declaratory Judgments Statute, 28 U.S.C. 2201, and the Patent Statute, 28 U.S.C. 1338. Defendant by his Answer (R-14) impleaded a License Agreement with a predecessor of plaintiff. At trial plaintiff asserted that the License Agreement, if valid and binding upon plaintiff, contained a price fixing provision and asserted an additional ground for jurisdiction under the Anti-Trust Act, 15 U.S.C. § 15 and § 26. Appellant appeals from an adverse Judgment. Jurisdiction of this appeal is based upon Title 28 U.S.C. § 1291.

II STATEMENT OF THE CASE

A. THE NATURE OF THE CONTROVERSY

This action was instituted by the appellant for a Declaratory Judgment holding defendant's United States Letters Patent No. 3,193,300 invalid. Appellant's Complaint (Complaint R-6) alleges that the defendant claimed and notified plaintiff that certain ski pole rings sold by plaintiff infringe defendant's patent. Appellee by his Answer alleges that plaintiffappellant is assignee of one Edward L. Scott, a licensee, and impleaded the License Agreement (Answer R-14). Appellee asserts that he has not contended that appellant has infringed his patent. This appeal relates to the question of whether or not appellant has been regarded as an infringer by appellee and whether or not the Court should pass upon the validity of the patent in any event because of the presence of a price fixing provision in the License Agreement.

B. THE PARTIES

Appellant is an Idaho corporation with it's principal place of business at Ketchum, near Sun Valley, Idaho. Appellee is also a resident of Ketchum, Idaho.

C. THE PLEADINGS

The only pleadings filed in the action were appellant's Complaint filed on February 24th, 1966, and appellee's Answer filed on March 18th, 1966. A Pre-Trial Conference Order was filed on January 26th, 1967. (R-99). The only other pre-trial pleading germane to the issues presented on this appeal is defendant's Motion for Summary Judgment (R-105)

ed by the defendant February 15th, 1967, and denied ter hearing in open court on February 27th, 1967.

. THE FACTS DEVELOPED AT TRIAL

1. GENERAL FACTUAL BACKGROUND

The subject matter of this suit relates to ski poles hich consist of a shaft having a snow engaging ring ljacent its lower end and a hand grip at its upper stremity.

Appellant corporation was founded by one Edward. Scott and was the outgrowth of his conception and evelopment in the late 1950's of a new type of ski ble shaft. It was subsequently patented and Scott, ho had operated a retail ski shop in Ketchum, Idaho, ammenced to assemble, distribute and sell ski poles nown as the Scott Pole. The Scott Pole was an imediate success and by 1960 Scott had closed his reil business and was assembling, selling and distibuting his ski pole.

During the year 1960, Scott and the appellee colborated on the design for an improved ski pole ring. ppellee conceived an idea for the ring and in Octper, 1960, caused to be prepared and submitted to cott a non-exclusive non-assignable License Agreeent (Exhibit 41) providing for royalty payment to opellee which was executed by Scott without the enefit of independent legal counsel. Scott commenced sing the rings for his ski poles. Scott's financial posion was extremely precarious and payments were ade to appellee without any record or correlation of mounts due but on the basis of when Scott had money vailable.

In order to attract the necessary capital for his growing business, Scott in November, 1961, caused appellant corporation to be formed. Its stock was offered and sold to the public although Scott retained slightly over fifty per cent himself. Appellee meanwhile, following the execution of the License Agreement, in January, 1961, filed an application for Letters Patent on his ski pole ring. By the fall of 1961, many other manufacturers of ski poles were using the appellee's ski pole ring without payment of any royalty. Scott, at the time of formation of his corporation, did not assign his License Agreement with appellee to appellant corporation although he did convey all of the rest of his business assets and the appellant corporation assumed his liabilities. Appellant corporation continued making payments on Scott's account to appellee until 1963 when payments ceased.

In 1962 and 1963, appellee undertook to manufacture and market his ring under the name of Tempo and offered the ring to the trade. This venture was unsuccessful.

In early 1964, appellee commenced an action in the State Court for an accounting against Scott. This action was commenced prior to the issuance of any patent. The action did not come on for trial until the latter part of June, 1965. At the trial the appellee here, plaintiff there, moved for a continuance when a Motion for Non-Suit was interposed at the close of the appellee's case. Motion for Continuance was granted and while the matter was pending and under advisement by the State Court, on July 6th, 1965, appellee's Patent No. 3,193,300 (Exhibit 33) issued.

While the Motion for Involuntary Dismissal was

still pending and undisposed of in the State Court, Notice of Patent Issuance (Exhibit 39) was served by appellee's attorneys upon appellant, Scott and Precision Ski Pole Manufacturing Company. Thereafter, the Trial Court in the State action denied the Motion for Involuntary Dismissal that had been interposed by the defendant Scott and ordered the appellant herein to be made a party defendant. No further proceedings were conducted in the State Court and the action has been dormant since the latter part of 1965. At the time of trial of the instant case, the appellee (Plaintiff in the State Court) was not represented by counsel in the State Court.

Thereafter on February 24th, 1966, appellant commenced this action seeking a Declaratory Judgment declaring the Mc Donald Patent No. 3,193,300 invalid. By way of defense, appellee Mc Donald contended that appellant was the assignee of Scott under the License Agreement and that appellant was, therefore, estopped to challenge the validity of appellee's license. Appellee contended that he had not treated appellant as an infringer and that his patent was valid. Appellant asserted that Scott had not assigned his License to appellant company, that appellant had been served with a notice that it was an infringer, and that even if appellant were a licensee of appellee it should be permitted to challenge the validity of appellee's patent in order to determine the validity and enforceability of the price-fixing clause contained in the non-exclusive license existing between Scott and appellee. Appellant likewise asserted that the patent was invalid. Abundant testimony was taken on both the question of whether or not appellant was estopped to attack validity and the question of validity itself.

2. THE CHARGE OF INFRINGEMENT BY APPELLEE MC DONALD

With respect to the question of whether or not appellant had been regarded as an infringer by appellee, thus giving appellant standing to maintain this action, the witness Scott testified (pages 15-17, Transcript) in substance and effect that he was on the 30th day of August, 1965, President of appellant corporation and that very shortly thereafter he received in the United States mail Exhibit 39 which reads as follows:

"NOTICE OF PATENT ISSUANCE

To: Edward L. Scott d/b/a Ski Pole Specialists; to Scott Ski Pole Specialists Manufacturing, Inc., now known as Scott-U.S.A. and Precision Ski Pole Manufacturing Company and to James Donart, their attorney.

The undersigned attorneys for Robert J. Me Donald understand that you are making, using and selling ski poles which use the invention covered by our client's United States Patent No. 3,193,300 issued July 6th, 1965, and entitled "ski pole rings." You are hereby notified that any unlawful manufacture, use or sale of articles infringing this patent will not be tolerated and that our client, Robert J. Mc Donald, intends to enforce his rights.

Dated August 30th, 1965.

CRAMER, WALKER, POPE & PLANKEY Attorneys for Robert J. Mc Donald"

Appellant's witness, John Woodward, was then called and identified himself as Vice-President of Anderson & Thompson Ski Company, a distributor, importer and manufacturer of ski equipment for sales to retailers (page 18, Transcript, Lines 5-18). The witness Woodward testified (Transcript, Pg. 31) that his company had been marketing a ski pole ring since 1962 or 1963 which was very similar to the rings (Exhibit 18) sold by appellant. The witness further testified that he had never had any contractual relationship by license agreement or otherwise with the appellee (page 32, Transcript) and that in the latter part of 1965 he did, nevertheless, receive a Notice of Infringement from the appellee in the form of a letter from appellee bearing date of November 1st, 1965, addressed to Anderson & Thompson Ski Company on appellee's stationery and bearing the signature of the appellee. This notice, Exhibit 47, reads as follows:

"It is my understanding that you are still making, using or selling ski poles which use the invention or inventions covered by my U. S. Patent Nos. 3,193,300 and 3,204,974.

This is to notify you once again that any unlawful manufacture, use or sale of articles infringing these patents will not be tolerated and that I intend to enforce my rights."

The appellee McDonald testified upon being called for cross-examination by plaintiff (Lines 8-15, page 78, Transcript) that notices were sent to others in the trade. This statement by appellee was coupled with the suggestion that his then attorneys, Kramer, Walker, Pope & Plankey, had sent notice to appellant without authority and the assertion that he had never seen the notice sent by them until he got their records after many months of trying (Pages 79-80, Transcript).

3. THE PRICE FIXING CLAUSE IN THE LICENSE AGREEMENT FROM APPELLEE MC DONALD TO EDWARD L. SCOTT

The License Agreement in question (Exhibit 69) bears date of October 6th, 1960, and was executed by the appellee (as licensor) and Scott (as licensee), now President of the appellant Company. Paragraph 8 thereof reads as follows:

"It is hereby specifically agreed that the parties hereto contemplate items manufactured in accordance with the aforesaid invention are to be sold as quality items at or above the highest price of comparable items on the market. If the licensee desires to market cheaper models, he must obtain consent of the licensor in writing to sell items below the highest price of comparable items on the market."

Paragraph 1 of the license provided that it was non-exclusive and covered both the United States and Canada. The license was signed before a patent application was filed in the United States and no application was ever filed in Canada.

In order to illustrate the ease with which appellee himself could have fixed and established prices of his device, counsel for appellant upon cross-examination of appellee elicited from appellee that he himself (since the license to Scott was non-exclusive) had embarked upon his own enterprice to manufacture and sell his device under the trade name of Tempo, and that although the enterprise was unsuccessful, he did, nevertheless, produce samples and undertake to sell to others in the trade. His sample Tempo ring (Exhibit 82) was admitted in evidence (Pages 349-350, Transcript).

E. DISPOSITION OF THE CASE BY TRIAL COURT

The Court by its Memorandum Decision (R-198) held that appellant corporation was the alter ego of the witness Scott as President; that the appellant was a licensee and therefore estopped to deny vaidity of appellee's patent. The Court held that the Notice sent to appellant was ambiguous and not intended as a claim of infringement and that appellant was not justified in considering the same as a claim of infringement and therefore was not relieved of the estoppel of the License Agreement. The court refused to pass upon the effect of the price-fixing provision in the License Agreement and held that t could be best left for disposition by the State Court and declined to pass upon the issue. The Court did not reach the issue of validity of the patent although extensive testimony was taken on both sides, out stated in its Opinion that it was in a position to render a decision on the question of patent validity and that it could, in the event of reversal upon apceal, render a decision on that question without taking further evidence.

III SPECIFICATIONS OF ERRORS

- 1. That the Court erred in failing to pass upon and ind defendant's patent invalid.
- 2. That the Court erred in failing to pass upon the question of price fixing appearing in the License Agreement.
- 3. That the Court erred in finding that the notice given to appellant (Plaintiff's Exhibit No. 39) by appellee was not a notice of claim of infringement.

- 4. That the Court erred in denying Plaintiff's Motion to Alter and Amend Judgment.
- 5. The Court erred in denying Plaintiff's Motion for New Trial Under Rule 59, Federal Rules of Civil Procedure.
- 6. The Court erred in denying Plaintiff's Motion to Amend or Make Additional Findings of Fact and Conclusions of Law.

IV ARGUMENT

At the outset, appellant sets forth herein its propositions of law and authority upon which argument herein is based; they are:

- 1. A patentee who treats his licensor as an infringer is estopped to assert the License as a defense to a claim of invalidity of the patent. N.S.W. Company vs. Wholesale Lumber and Millwork, 123 Fed. 2d 38, 6th Cir., 1941; Bucky vs. Sebo, 208 Fed.2d 304, 2nd Cir., 1953; Consolidated Electro. Corporation vs. Midwestern Instruments, 260 Fed.2d 811, 10th Cir., 1958.
- 2. An ambiguous notice must be construed most strongly against the person who gives it. 66 C.J.S. Notice, Sec. 19a, p. 668; Carpenter v. Thurston, 30 Cal. 123, 125.
- 3. In determining whether third persons can rely upon acts of an attorney as being binding on his client the rules of agency apply. 7 C.J.S., Attorney & Client, Sec. 67, p. 850.
 - 4. A principal is bound by acts of his agent acting

within the bounds of his apparent authority. Restatement of Agency (2nd Ed.) Secs. 160, 161.

- 5. A client is bound by his attorney's acts and if ne does not want to be bound he must disaffirm those acts promptly. Yahola Sand & Gravel v. Marx, 358 P.2d 366; Hot Springs Coal v. Miller, 107 Fed.2d 677.
- 6. Plaintiff cannot withdraw charge of infringement after commencement of declaratory judgment action to test validity of patent and thus avoid a controversy and defeat jurisdiction. Hawley Products Co. v. U. S. Trunk, 259 F.2d 68, 1st Cir., 1958.
- 7. Any person who shall be injured in his business or property by reason of anything forbidden in the Anti-Trust Laws may sue therefor in any District Court in the United States in which the defendant resides or is found or has an agent without respect to the amount in controversy. Title 15 U.S.C., Sec. 15.
- 8. A Declaratory Judgment action in which the Court is asked to declare a contract illegal under the Sherman Act presents a federal question sufficient to give a Federal District Court Jurisdiction. Southside Theaters Inc. et al. vs. United West Coast Theaters Corporation et al, 178 Fed.2d 648, 651, 9th Cir., 1949; Rambusch Decorating Company vs. Brotherhood, etc. of America, 105 Fed.2d 134, 2nd Cir., 1939; Cert. den., 308 U.S. 587, 60 SCt 110, 84 L.Ed. 492.
- 9. A declaratory judgment action may be brought by a patent licensee against the licensor to declare a License Agreement invalid on the ground that a price-fixing arrangement in the agreement is violative of the Sherman Act. Consolidated Packaging Machinery

Corporation vs. Kelley, 253 Fed.2d 48, 7th Cir., 1958; Cert den., 78 S.Ct. 1151, 357 U. S. 906.

- 10. When there is a contract between the parties to a federal action and a state court action is pending based upon the contract, the federal court is without discretion to refrain from exercising jurisdiction when the federal action is under the Federal Anti-Trust Laws. Mach-Tronics, Inc. vs. Zirpoli, 316 Fed.2d 820, 9th Cir., 1963; Lyons vs. Westinghouse Electric Corporation, 222 Fed.2d 184, 2nd Cir., 1955; Lear Siegler Inc. vs. Adkins, 330 Fed.2d 559, 602, 9th Cir., 1964.
- 11. A non-exclusive licensee can attack the validity of the licensor's patent if the license contains a price-fixing clause because such a clause is a violation of the Sherman Act unless it is within the protection of a lawfully granted patent monopoly. Sola Electric Company vs. Jefferson Electric Company, 317 U. S. 173, 177, 87 L.Ed. 168, 63 S.Ct. 172; Edward Katzinger Company vs. Chicago Metallic Manufacturing Company, (1947) 329 U. S. 394, 67 S.Ct. 416, 91 L.Ed. 374; Bowers Manufacturing vs. All-Steel Equipment, Inc., 275 Fed.2d, 809, 811, 9th Cir., 1960.
- 12. A royalty agreement that project beyond the term of a patent is unlawful per se. *Brulotte v. Thys Co.*, 379 U.S. 29, 32, 85 S.Ct. 176, 13 L.Ed. 2d 99, 102, (1964).
- 13. Estoppel to question the novelty of a patented device must be considered a doctrine of very limited validity. *Douglass vs. United States Appliance Corporation*, 177 Fed.2d 98, 101, 9th Cir., 1949.
 - 14. Patent monopoly rights must have their origin

under the patent laws and cannot be created by private contract. Cable Vision, Inc. v. KUTV, Inc., 335 F.2d 348, 351, 9th Cir., 1964.

15. The issue of price fixing or other illegal provision in a contract can be raised at any time during he proceedings. Edward Katzinger Company v. Chiago Metallic Mfg. Co., supra.

16. An illegal price fixing clause in a license is not everable. Edward Katzinger Company v. Chicago Metallic Mfg. Co., supra.

A. THE NOTICE OF AUGUST 30, 1965, FROM APPELLEE'S ATTORNEYS TO APPELLANT WAS A CHARGE OF INFRINGEMENT

For the purpose of this argument, it is assumed hat appellant is in fact a licensee, an assumption hat in itself could be subject to serious dispute in riew of the state of the record. If one indulges in hat assumption, nevertheless, appellee is immediately net with the notice (Exhibit 39) dispatched to appellant (Pages 15-17, Transcript) which during the rial he tried to avoid by suggesting that it was sent by his then attorneys without his authority. The Court in its Memorandum Decision on the other hand dermed it ambiguous. In this respect appellant respectfully submits that the Court erred and that heither position is tenable in view of the substance of the notice and surrounding circumstances.

The Court (p. 6 of its Memorandum Decision) ound that the Notice "was not intended as a claim of infringement," and yet McDonald's then attorneys who sent the Notice did not testify at the trial, and McDonald testified that he did not see the Notice for

several months (page 80, Transcript) after it was sent. Therefore the only basis for this finding of the Court was the Court's statement concerning McDonald's after-the-fact self-serving conclusion of law to the effect that in his opinion neither Scott or appellant could have infringed (page 6, line 13, Memorandum Decision) and the Court's statement that McDonald "further averred that he had always advised his attorneys that the plaintiff could not be considered as an infringer" (page 6, lines 13-15). Even if this had been a sufficient basis for the Trial Court's opinion, or if one is to believe because of the case that he cited as authority (Dr. Beck & Co. G.M.B.H. v. General Electric Company, 2nd Cir. 1963, 317 F.2d 538), that he was finding that the Notice in question was sent by McDonald's attorneys without his actual authority, it still fails to meet and recognize the real problem which is one of apparent authority. In other words, what did the appellant. recipient of the Notice, have a right to believe from the Notice?

There is absolutely no question that when the Notice was received by appellant, Kramer, Walker, Pope & Plankey were McDonald's attorneys in all questions respecting the State action and the subject matter of the License Agreement including the patent. It is difficult to conceive of a situation in which there could be more obvious apparent authority of an attorney to send a notice of infringement on behalf of a client. The relation of attorney and client is one of agency, and the general rules of law apply including the doctrine of apparent authority.

The Trial Court also emphasized in its Opinion (p. 6) that "McDonald stated under oath the plain-

vas not an infringer to the patent in question." statement is irrelevant in view of the at least rent authority of McDonald's then attorneys to the Notice, and in view of the fact that a ree, after having given a notice of infringement ing the basis for a declaratory judgment action red to a determination of the validity of the at, cannot by revoking the charge after the action been commenced by the alleged infringer, thereform a basis for dismissal of the action. If this not true a patentee could make indiscriminate angement charges and then always escape the contences by later making a self-serving revocation.

en though the doctrine of apparent authority oses of the question, appellant must point out the that scarcely two months after the Notice to llant, McDonald himself sent notices with subcially the same wording to other ski pole manuurers including Anderson & Thompson (Exhibit quoted earlier in this Brief.* On cross-examina-McDonald admitted (Page 78, Transcript) that notices he sent were notices of patent infringe-. It must be more than mere coincidence that two notices are almost identical with respect to language used and that they are identical in tance. It is virtually impossible not to believe appellee had before him the notice composed by attorneys on August 30th, 1965, addressed to apant at the time he composed his notice to Ander-& Thompson Ski Company two months later. It kewise extremely difficult to suppose that ape in composing the notice to Anderson & Thomp-Ski Company and copying the notice sent to the appellant may have thought that the notice to appellant was not a notice of infringement. Significantly, the appellee did not assert during Trial that the notice was ambiguous, but asserted instead that his attorneys sent it without authority.

The only other factor which the Trial Court could have considered in holding that appellant was not justified in considering the notice (Exhibit 39) as a claim of infringement would be the posture of the parties at that time. However, when such is carefully examined, it was not at all illogical for appellant to have considered that it was being treated as an infringer. Appellee had commenced an action against Scott, President of the appellant company (Page 282. Lines 3 through 25, Transcript). The action had been commenced in April of 1964 (See pleadings attached to Exhibit on Appellee's Answer, R-14). The suit was based upon the License here in question and was not tried until June of 1965, a few days prior to issuance of appellee's patent. At the conclusion of plaintiff's evidence (Appellee here) Motion for Non-Suit and Involuntary Dismissal was made by the defendant. Questions raised by the Motion were of sufficient seriousness and complexity that the trial thereupon stopped and was continued so that the Court could take defendant's motion under advisement and make a deliberate ruling based upon written briefs. The continuance that was granted for this purpose was a highly unusual thing in itself. Plaintiff therein, appellee herein, thereafter filed motions to have certain other parties brought into the State Court action including the appellant. The questions presented were of sufficient gravity that on August 30th, 1965, the day when the notice (Exhibit 39) concerning the patent, which had in the meantime issued, was dispatched to appellant, the matters had still not been resolved. Appellant submits that in that posture, it was not in the least illogical for appellant to assume that appellee, becoming daily more fearful as to what the ultimate decision of the Court might be in the State case, decided to perfect a possible alternative cause of action based on patent infringement which could not have come into being until his patent issued on July 6, 1965.

Considering the fact that both parties were represented by counsel in the State action, that the very heart of that case was the License Agreement, and that several times counsel for appellant had urged as a defense during the proceedings in the State action that no patent had issued on the licensed invention, it would be the usual and ordinary practice for appellee's attorneys to have contacted appellant's attorney directly by telephone or letter to advise of the issuance of the patent. Instead, the Notice in question was mailed directly to appellant by appellee's attorneys and the wording is far more formal and detailed than would be expected if the intent was merely to simply advise that the patent had issued. It seems far more like a notice of infringement in accordance with Title 35 U.S.C., Section 287.

In any regard, even if the Notice be considered ambiguous, the normal rule of construction requires that any doubt as to the meaning thereof, resulting from an ambiguity in its terms, be resolved against the person (appellee) who gave the notice. 66 C.J.S. Notice, Sec. 19a, p. 668. "If it fails to convey clearly his meaning to the other party the fault is his, and the consequences must be on him." Carpenter v. Thurston, 30 Cal. 123, 125 (1866).

The Court in its Opinion (Memorandum Decision, Page 6, R-198) in part bases its determination of the Notice issue upon the fact that under cross-examination, appellant's President, Scott, had never claimed an infringement by appellant except with the notice (Exhibit 39). Appellee knows of no rule of law that requires more than one notice of infringement. Furthermore, the record does not disclose nor has there in fact been any communication between appellant and appellee, other than the Notice, since July 6th, 1965, date of issuance of the patent, which would be the first day upon which anyone could be an infringer.

The rule is well recognized that a patentee who treats its licensee as an infringer is estopped to assert the license as a defense to a claim of invalidity of the patent. The case of Bucky v, Sebo, 208 Fed.2d 304, 2nd Cir., 1953, is closely in point. In that case the defendant had an exclusive license with a specific provision that it would never contest validity of the patent. After paying royalties for some period of time, the defendant ceased payment whereupon plaintiff gave notice in writing to the defendant that its license was at an end. Plaintiff then brought suit against the defendant for infringement. Defendant raised the defense of validity of the patent and the trial court held the defendant was estopped as a licensee to assert that defense. On appeal the trial court was reversed and significantly it is noted in the footnote that the scope of the estoppel rule applied by the trial court is narrowing. The court stated the rule at Pages 305 and 306 as follows:

"We think for the following reasons, the judge erred in respect of estoppel concerning infringement: During the existence of a patent license

the licensee may be estoppel to contest validity. But even this estoppel usually vanishes when the license terminates, either because of lapse of time or through complete repudiation of the license by the licensee by act of the licensor."

ther authorities for the rule are N.S.W. Company Wholesale Lumber & Millwork, 123 Fed.2d 38, 6th Cir., 1941, and Consolidated Electro Corporation v. Midwestern Instruments, 260 F.2d 811, 814-5, 10th Cir., 1958.

THE LICENSE AGREEMENT IS ILLEGAL ON ITS FACE AND THE TRIAL COURT SHOULD HAVE PASSED ON THIS ISSUE

It has been long established that "a court will not and its aid, in any way, to a party seeking to realize the fruits on an agreement that appears to be tainted ith illegality, although the results of applying that all may sometime be to shield one who has got mething for which, as between mand and man, he aght, perhaps, to pay, but for which he is unwilling pay." Continentall Wall Paper Co. v. Louis Voight Sons Co., 212 U. S. 227, 262, 29 S.Ct. 280, 53 L.Ed. 36, 505, (1908). In the present case the Licensee greement in question (Exhibit 69) was executed for $4\frac{1}{2}$ years prior to the issuance of the patent on the licensed invention without appellee having independent counsel and contains the following illegal covisions:

"5. The License shall extend for the term of the life of any patent or patents issuing on said invention or direct improvements thereof, or, if no such patents issue, for a period of seventeen years from the date of this Agreement. It is specifically understood that part of the consideration of this Agreement is the disclosure the Licensee by Licensor of the structure of the invention together with information pertaining the mode of manufacturing the same, and accordingly the royalty payments shall continue so long as the Licensee manufactures or sells devices in accordance with said invention whether or not a patent or patents issue and whether on the any patents which may issue are held invalid

8. It is hereby specifically agreed that the parties hereto contemplate items manufactured is accordance with the aforesaid invention are to be sold as quality items at or above the highest price of comparable items on the market. If the Licensee desires to market cheaper models, he mustirst obtain the consent of the Licensor, in writing, to sell items below the highest price of comparable items on the market." (emphasis added

It will be noted that the first of these, Paragraph not only requires Licensee (appellant) to pay roya ties before the patent issued and during the term of the patent, but to pay royalties for 17 years (the normal life of a patent) even if a patent never issued or if it did issue, to pay royalties beyond the term of the patent, even if held invalid. In Brulotte v. The Co., 379 U. S. 29, 32, 85 S. Ct. 176, 13 L.Ed.2d 99, 10 (1964), the Supreme Court held "that a patentee use of a royalty agreement that projects beyond the expiration date of the patent is unlawful per se (emphasis added) Parties can't by contract "boo strap" into existence rights from subject matter: the public domain. Cable Vision, Inc., v. KUTV Inc. 335 F.2d 348, 351, 9th Cir., 1964.

The second of these quoted clauses, Paragraph is clearly a price-fixing provision. At the trial it we developed through the testimony of the appellee M

conald (Pages 348-350, Transcript) that he had in ct undertaken a manufacturing and marketing energise of his own in competition with his non-excisive licensee Scott to manufacture and sell the roduct in question under the trademark "Tempo." Ithough this enterprise was unsuccessful it is significant that this enterprise serves to symbolize that would have been possible for appellee, because of the above quoted license provision defining minimum rice, to manufacture and sell the licensed product and thus establish the minimum price at which his tensee could sell the product.

It is well established that a contract containing a rice-fixing provision is invalid as being a violation the Sherman Anti-Trust Act, 15 U.S.C.A. 1-7, 15 te, unless the contract is a license under a lawfully anted patent monopoly. Continental Wall Paper o. v. Louis Voight & Sons Co., supra; Sola Electric ompany v. Jefferson Electric Company, 317 U.S. 3, 63 S.Ct. 172, 87 L.Ed. 165, (1942); Edward atzinger Company v. Chicago Metallic Manufacturg Company, 329 U.S. 394, 67 S.Ct. 416, 91 L.Ed 4, (1947). As previously mentioned, when the Linse Agreement in the present case was executed in 60 there wasn't even an issued patent (issued in 65). Therefore, the License Agreement was clearly valid when entered into, as a consequence of the ice fixing clause, because at that time the contract d not have the benefit of any patent monopoly. ertainly, it is illogical to conclude that a contract nich is invalid at its inception can take on a valid le nearly five years later because a patent then sued, particularly when the licensee, as in the prest case, had discontinued making any payments nder the Agreement long before the patent issued.

To so conclude when the contract was also illegal per se, as in the present case, because it required royalties to be paid beyond the expiration date of the patent would be a complete disregard for public policy.

The Trial Court declined to accept or pass opinion on the illegality of the License Agreement (Memorandum Decision, Page 7, R-198) with the statement that the price fixing issue represented a last moment effort by appellant to attack validity of the License Agreement and the further statement that it could best be left to the State Court which has before it the contract for enforcement. The issue of the illegality of the license was brought to the attention of the trial court in conference prior to trial, testimony was developed bearing upon it during the trial (Line 16, p. 349 through line 25, p. 350, Transcript of Testimony) and it was vigorously urged with abundancitations of authority in oral argument at the trial

To leave this question to the State Court is im proper and an over-simplification of the issue Neither the validity of the patent nor the price-fixing provision is in issue in the State Court. Even if the pleadings could be amended so as to question validity of the patent in the State Court and thus determin the validity of the price fixing provision, or if a nev and independent action were commenced, it would still place a tremendous financial burden on both the litigants and compel a repeat of the expenditure of talent, time and money that the record amply dis closes was expended in the instant case. This is madall the more apparent by the court's statement in it Memorandum Decision (page 7) that it has in fac arrived at a conclusion on the question of paten validity. Hence no further trial is required to conetely dispose of all of the issues between the parties ised herein.

From a reading both of the Supreme Court decision Edward Katzinger Company v. Chicago Metallic anufacturing Company, supra, and the report of the coceedings had in the Seventh Circuit, 139 F.2d 291, appears that the issue of price fixing was not raised atil after trial and before entry of the trial court's scree.

Even if the License Agreement in the present case ed not been entered into until after the McDonald tent issued, the law is well settled that a licensee such an instance is freed from any estoppel to chalnge the validity of the patent and thus determine hether or not the License Agreement is in violation the Anti-Trust Laws of the United States. This is cause a price flxing clause in a license agreement n only be valid if the licensed patent is valid. The ndmark case in this area is the case of Sola Elecic Company vs. Jefferson Electric Company, 317 . S. 173, 63 S.Ct. 172, 87 L.Ed. 165 (1942). In Sola, aintiff instituted an action for a specific performace of a license contract covering patented articles oon which plaintiff had a patent. Defendant anvered and filed a counter-claim alleging certain patits covered by the License Agreement to be invalid nd asserted its right to question validity by reason a price-fixing clause in the contract. The trial court eld that defendant was estopped to challenge vality. This was affirmed by the Seventh Circuit but as reversed by the Supreme Court. Mr. Chief Jusce Stone speaking for the court stated the issue as llows:

"The question for our decision is whether patent licensee is estopped to challenge a pric fixing clause in the agreement by showing that the patent is invalid, and that the price restriction is accordingly unlawful because not protected by the patent monopoly."

After determining that the defendant-appellant coul in fact seek a declaratory judgment to determin validity of the patent and hence determine the legality of the price-fixing agreement, the Suprem Court concluded with the following language:

"Local rules of estoppel which would faste upon the public as well as the petitioner the burden of an agreement in violation of the Sherma Act must yield to the Act's declaration that suc agreements are unlawful, and to the public polic of the Act which in the public interest preclude the enforcement of such unlawful agreements."

The case of Edward Katzinger Company vs. Ch cago Metallic Manufacturing Company, supra, i further enlightening because of the fact that the factual situation encountered there was so nearl identical to the posture of the parties in the instar case. Metallic sold pans upon which Katzinger claime to have a patent. Metallic paid royalties for a time It then decided that certain of the pans that it solvent were not covered by Katzinger's patent and Metalli declined to pay any more royalties. The license i question contained an extensive price-fixing agree ment giving the licensor in effect the right to fi prices. The contract likewise provided that if Metall! elected to terminate the contract without ceasing t manufacture the pans, Metallic should be estoppe from denying the validity of the patent and be deeme an infringer thereof. Metallic gave notice of termina on of the contract and initiated an action for a claratory judgment declaring the patent invalid for ant of invention. Katzinger in his answer and unter-claim alleged that Metallic was estopped to allenge the validity of the patent.

In the Supreme Court it was also contended that e court should treat the price-fixing provision of e license as severable. However, in its Opinion the apreme Court not only held that "price-fixing agreemts such as those here involved are unenforcable cause of violations to the Sherman Act save as they ay be within the protection of a lawful patent," It also made it clear that the presence of the price-ing provision must cause the whole license to fail. stated the rule as follows:

"Metallic's obligation to pay the royalties and its agreement to sell at prices fixed by Katzinger constituted an integrated consideration for the license grant. Consequently, when one part of the consideration is unenforcable because in violation of law, its integrated companion must go with it."

Since the Sola and Katzinger Opinions by the Sueme Court of the United States, there have been any decisions elaborating upon the scope of federal risdiction in Anti-Trust cases. In the case of Lyons. Westinghouse Electric Corporation decided in 55 by the Second Circuit, 222 Fed.2d 184, a case nich did not deal with a patent license but which as grounded upon the Clayton Act, that Court issued Writ of Mandamus to the Federal Trial Judge recting that he vacate a stay order which had been tered staying further proceedings in an action in the Federal Court brought under the Clayton Act anding disposition of an action in the State Court wherein the same parties were also parties and where certain of the acts complained of in the Federal Court constituted a defense that had been asserted in the State Court. In granting the Writ and directing that the stay order be vacated, Judge Learned Hand stated the rule at page 189 as follows:

"In the case at bar it appears to us that the grant to the district courts of exclusive jurnsdiction over the action for treble damages should be taken to imply an immunity of their decisions from any prejudgment elsewhere; at least on occasions, like those at bar, where the putative estoppel includes the whole nexus of facts that makes up the wrong. * * * There are sound reasons for assuming that such recovery should not be subject to the determinations of state courts. It was part of the effort to prevent monopoly and restraints of commerce; and it was natural to wish to be uniformly administered, being national in scope."

It is significant that in the *Lyons* case the proceeding in the State Court had actually gone to judgment and there remained only a pending appeal.

It would appear therefore in the instant case that the Trial Court had no choice but to pass upon the question of price-fixing and the validity of the contract and could not leave it to be dealt with by the State Court. This Court has so held in the case of Mach-Tronics, Incorporated vs. Zirpoli, 316 Fed.2d 820, 9th Cir., 1963, wherein a Writ of Mandamus issued out of this Court directing the Federal Trial Judge to vacate a stay order previously entered. In that case an action had been commenced in the State Court in California. Among other things, the defendant in the State Court had pleaded as a defense cer-

in acts which would have been violative of the Fedral Anti-Trust Acts. Thereafter, the defendant in the State Court, plaintiff in the Federal Court, instited an action in the Federal Court based upon the layton Act whereupon the motion to stay proceedings in the Federal Court pending disposition of the State Court case was granted and plaintiff sought Writ of Mandamus. The Writ issued and this ourt stated the rule as follows at Page 824:

"It has long been recognized that when a federal court is properly appealed to in a case over which it has by law jurisdiction, it is its duty to take such jurisdiction. Wilcox v. Consolidated Gas Co., 212 U. S. 19, 40, 29 S.Ct. 192, 53 L.Ed. 382; Meredith v. City of Winter Haven, 320 U.S. 228, 234, 64 S.Ct. 7, 88 L.Ed. 9; Propper v. Clark, 337 U.S. 472, 69 S.Ct. 1333, 93 L.Ed 1480; Alleghany County v. Frank Mashuda, 360 U. S. 185, 188-189, 79 S.Ct. 1060, 3 L.Ed.2d 1163. It has also been considered to be the rule that when a federal court is presented with a case of which it has cognizance it may not turn the matter over for adjudication to the state court, and the pendency of an action in the state court is no bar to the proceedings concerning the same matter in the federal court. McClellan v. Carland, supra, 217 U. S. pp. 281-282, 30 S.Ct. 501."

his Court approved the above stated rule in the case Lear Siegler, Inc. vs. Adkins, 330 Fed.2d 595, 9th ir., 1964. Although that case was one in which this ourt upheld a stay order where no Anti-Trust queston was in issue in either the State or Federal Court, nevertheless, recognized the rule announced in the ecisions above cited at Page 602 as follows:

"The authorities upon which Lear relies are not in point. They involve actions in which the district court is without discretion to decline to exercise its jurisdiction, such as actions under the anti-trust laws (Lyons v. Westinghouse Electorp., 2 Cir., 1955, 222 F.2d 184; Mach-Tronic Inc. v. Zirpoli, 9 Cir. 1963, 316 F.2d 820)."

C. SUMMARY

- 1. Appellee Donald's attorneys had actual or apparent authority to send the Notice of August 30 1965, (Exhibit 39) to Appellant in behalf of Appellee
- 2. The Notice (Exhibit 39) to Appellant is worder like a notice of infringement, and Appellant had a right to consider it as such.
- 3. The License Agreement (Exhibit 69), prepared by Appellee's attorneys, was illegal and unenforcable when executed in 1960 long prior to the issuance of the McDonald patent (Exhibit 33), and therefor Appellant is not estopped to contest validity of the patent.
- 4. Even if the McDonald patent had issued prior t the License Agreement, Appellant (licensee) could have contested validity of the patent in view of th price fixing provision and/or the provision in the license that royalties shall be paid after the patent expires.

5. The Trial Court should have ruled on this issue the alleged illegality of the price fixing and other propoly extension provisions of the License Agreeent.

6. The Trial Court should have ruled on the validity the McDonald patent.

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CERTIFICATE OF SERVICE

A true copy of the foregoing Appellant's Brief has been sent to Lloyd J. Webb of Rayborn, Rayborn Webb & Pike, P. O. Box 321, Twin Falls, Idaho 83301 as attorney for Appellee, by United States mail postage prepaid, this.......day of December, 1967

Richard W. Seed .

CERTIFICATE OF COMPLIANCE

I certify that, in connection with the preparation of this Brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that in my opinion, the foregoing Brief is in ful compliance with these rules.

> Richard W. Seed Counsel for Plaintiff-Appellant

United States Court of Appeals

For the Ninth Circuit

Brief of Appellee Oroville-Wyandotte Irrigation District



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In the

United States Court of Appeals

For the Ninth Circuit

THE STATE OF CALIFORNIA, Acting by and through the DEPARTMENT OF WATER RESOURCES,

Appellant,

VS.

THE OROVILLE-WYANDOTTE IRRIGATION DISTRICT, an irrigation district, and the California Public Utilities Commission, a public commission,

Appellees.

Brief of Appellee Oroville-Wyandotte Irrigation District

STATEMENT OF THE CASE

Because appellant's statement of the case is intermixed with argument of the case, and contains assertions, assumptions and characterizations which are unfounded and unacceptable, appellee Oroville-Wyandotte Irrigation District (OWID) submits the following statement of the case.

A. The Parties. The Department of Water Resources (DWR) is an agency of the State of California, organized and existing under the Central Valley Project Act, California Water Code (W.C.) Div. 6, Pt. 3, containing, inter alia,

Sections 11590-11592 which it now contends are invalid and unenforcible against it. (O.B. 32-39)

OWID is an irrigation district organized and existing under W.C. Secs. 20500 et seq. and, as such, is also an agency of the State of California. W.C. Sec. 11102 (CT 67)

B. The Facilities. Since early 1963 OWID has operated dams and related power generating and water storage and transmission facilities in and near the South Fork of the Feather River to supply domestic and agricultural water users in and around Butte County (the South Fork Project). (CT 73, 162) This project was originally licensed by the Federal Power Commission (FPC) in 1952. (11 FPC 1129) Its design conformed to a plan drawn up in 1954 by DWR's predecessor, the California Division of Water Resources. (CT 190-191, 199) DWR included it in the California Water Plan which it promulgated in 1957. (CT 159) Thereafter, in 1958, it was successively reviewed and approved by the California State Water Rights Board (CT 160), the California Water Commission (an agency within DWR) (CT 160, 201-204), and DWR itself. (CT 160, 206-221) In 1960, the California Districts Securities Commission and the California State Controller authorized public sale of bonds to finance the project (CT 73), and construction began in the Summer of 1960. (CT 162)

One of the features of the South Fork Project is Miners Ranch (MR) Canal. Originally planned exclusively as an irrigation facility (see CT 190-191), the Canal's design was enlarged in 1958 so that it could be used for power purposes as well (see CT 214), and the project license was amended to reflect its character as a power facility in 1959. (21 FPC 613)

In late 1967, DWR completed Oroville Dam on the South Fork of the Feather River; as water accumulates behind the Dam Oroville Reservoir will be formed. (CT 53) Both the Dam and Reservoir are features of DWR's Oroville Project. In 1957 DWR was authorized by the California Legislature to construct this project (W.C. § 11260), and it obtained an FPC license in the same year. (CT 53) Construction of this project had not been completed when this action was commenced. (CT 53)

C. DWR's Change of Position. Since before 1957, it has been known that completion of Oroville Reservoir might create conditions which would adversely affect certain parts of the South Fork Project, including MR Canal. (17 FPC 262, 263; 28 FPC 760) Beginning not later than 1963, DWR and OWID undertook negotiations and reached certain agreements to deal with these adverse effects, based upon the assumption that DWR would be responsible for the adverse effects of its reservoir. (CT 73-74, 79-81) On May 11, 1966, however, DWR reversed its position and denied responsibility. (CT 75)

D. Administrative Proceedings. Faced with this threat to the continuing dependability of the water supply to Butte County, OWID filed an application for relief with the California Public Utilities Commission (CPUC). (Ex. C to DWR's First Amended Complaint, CT 67-82) That application stated that it was filed "pursuant to the provisions of the Water Code", namely, Sections 11590-11592, which provide in substance that when DWR takes or destroys the public service facilities of another state agency in the construction of the Oroville Project, it shall provide substitute facilities, and that the CPUC shall determine disputes in this respect between state agencies. (Opening Brief, "O.B.", App. C, p. 60)

DWR moved to dismiss the application (CT 88-102), but even before the CPUC had denied that motion by its order of March 28, 1967 (CT 282-284) filed the instant action against OWID and CPUC. (CT 103) By letter of October 11, 1966, DWR had asked the FPC to investigate this matter but it took no formal steps to invoke the jurisdiction of that Commission, either by complaint or petition. (CT 55-56) In November 1966, OWID, pursuant to the provisions of its FPC license, filed with the FPC for routine approval the final drawings showing its project as built. (CT 56-57) Subsequently, DWR filed a protest with FPC against such approval (CT 410-411) and hearings have now been held before an FPC hearing examiner who has issued an initial decision. Exceptions to that initial decision will be filed with the FPC shortly.

E. Proceedings Below. Both OWID and CPUC moved to dismiss this action in the court below but before a ruling was made on the motions, DWR, on June 23, 1967, filed a motion for a preliminary injunction to enjoin the holding of the CPUC hearing on OWID's application. After hearing on DWR's motion, and OWID's and CPUC's motions to dismiss, the trial court denied the preliminary injunction and granted the motions to dismiss. (CT 535-536) Thereafter the hearing before the CPUC was held and the case before it now stands submitted. (O.B. p. 55)

SUMMARY OF THE ARGUMENT

The only issue on this appeal is whether the judgment dismissing the amended complaint was correct. That judgment was properly based on the ground that the action had been brought prematurely. The declarations sought were hypothetical and abstract, and would not have terminated the dispute. They would, moreover, have intruded unnecessarily and prematurely into the relations between agencies of the State of California and into the relations between the state and federal governments, at a time when the determinative issues were before the appropriate administrative

agencies for decision and no orders had as yet been made. Under the doctrine of *Public Service Commission of Utah* v. Wycoff Co., 344 U.S. 237 (1952), and other cases, the trial court exercised its discretion properly in dismissing the action.

DWR's contention that Sections 11590-11592 of the California Water Code are invalid as applied to this case, and that the CPUC is without jurisdiction, is premature until the administrative process has been exhausted. In any event, it is wrong. The Federal Power Act (the Act) does not preempt the field of determination of liability for damage done by a licensee's operations and provides no forum for this purpose. The CPUC retains jurisdiction of such questions, particularly where the dispute is between two state agencies, even though any order issued by it involving modification of a project licensed by FPC would require FPC approval.

DWR is not entitled to injunctive relief against the CPUC proceedings for the foregoing reasons, and for the further reason that it has not demonstrated that it has suffered or will suffer any harm. Federal courts will not enjoin state administrative proceedings in the absence of a clear showing of interference with federally protected activities, and nothing of the sort is involved here.

Finally, comity requires that in the absence of compelling circumstances, federal courts not interfere with proceedings of state administrative agencies, particularly where, as here, the matter concerns problems of local concern, such as the maintenance of a local water supply and the administration of state law applicable to state agencies and designed to deal with the problem.

ARGUMENT

- I. The Court Below Properly Dismissed the Action as Premature.
- A. THE RELIEF SOUGHT IS NOT APPROPRIATE FOR A DECLARATORY OR INJUNCTIVE ACTION.

DWR's first contention is that the court below erred in finding that the "action has been brought prematurely". (CT 492) The argument is that the action is not premature (1) because there is now a controversy between DWR and OWID over the lawfulness of OWID's construction of the Canal and its appurtenances and over what is to be done about the encroachment of DWR's project on OWID's facilities and (2) because there is an urgent need to determine and perform any work that may be required as a result. (O.B. 26-29)

This argument completely misses the point. The issue here is not whether this is the time to resolve the controversy so that necessary work can begin. The fact is that the FPC and the CPUC are now actively engaged in resolving it. The issue instead is whether this is an appropriate time for the *court below*, or any federal court, to step into the dispute. The answer to this question is plainly no.

The appropriate point for federal court intervention, even were this an ordinary private dispute, has not been reached as yet. This is apparent from DWR's own authority which declares that federal court intervention is proper only when the court can grant "specific relief through a decree of a conclusive character, as distinguished from an opinion advising what the law would be on a hypothetical state of facts." Aetna Life Insurance Co. v. Haworth, 300 U.S. 227, 241 (1937) (quoted at O.B. 26).

The prayer for the declaratory relief sought appears in the amended complaint in substance as follows: "1.a. That [DWR]...has and will have no liability or duty to [OWID] to protect its Miner's Ranch Canal from or in connection with affects [sic] cause [sic] by operation of the Oroville Project...

"1.b. That [FPC] has exclusive jurisdiction to determine whether any protection to or relocated or substitute facilities... will be required...

"1.c. That in making...its application to [CPUC] [OWID] is violating the Federal Power Act...

"1.d. That...the Oroville Project...will not take or damage any lands or property belonging to [OWID]";

"That...the Court declare what lands or property will be taken [if any]...and that [DWR] is entitled to acquire the same by [eminent domain action].

"That...the Court...declare who...would be

liable [for such taking] ...

"1.e. That [DWR] is entitled to eject [OWID] from lands...withdrawn and reserved for...the Oroville project". (CT 62-64)

In addition, the prayer is for an injunction against CPUC and OWID prohibiting prosecution of OWID's application before the CPUC. (CT 64)

This prayer plainly calls for what the Haworth case described as "an opinion advising what the law would be on a hypothetical state of facts. . . ." (p. 241). How, for example, could the court now make a blanket declaration for all time that DWR would not in any circumstances be iable for damage to OWID's Canal, regardless of how in the future it might be caused? How could the court properly make a determination that FPC had exclusive jurisdiction to determine whether any protection to or relocated or substituted facilities will be required when FPC had not asserted such exclusive jurisdiction and DWR had not even

sought to invoke it (or, conversely, if FPC is now making such a determination, what useful purpose would be served by such a declaration)? How could the court properly declare that the filing of an application with the CPUC pursuant to state law is a violation of federal law, when there has been no order made or other state action taken? How could the court properly speculate as to whether in the future there would or would not be damage to OWID's facilities and what it will be? And, finally, how could the court properly declare in this action that DWR may in the future be entitled to prevail in actions against OWID in eminent domain and ejectment, when DWR has chosen not to bring such actions? In short, the court below was entirely correct in holding that it was inappropriate for it to resolve such purely abstract and hypothetical issues.

Nothing has occurred to create a conflict of jurisdiction between FPC and CPUC; nothing has occurred which impairs any federal rights or claims of DWR or its ability to assert those rights or claims, either by seeking affirmative relief, such as ejectment or condemnation, or in defense against the claim asserted by OWID. DWR is free to do all these things, and hence does not need the advisory opinion of the District Court on yet hypothetical questions. And even if such an opinion were rendered it would not end the litigation, for it would still leave the administrative agencies with the problems of what is to be done about the effects of the Reservoir and how the people of Butte County are to get water service. That problem is before them at present. For the District Court to proceed with this action would do nothing to help speed the needed determinations. On the contrary, it threatens to tie the hands of the agencies vet it would not, and could not, provide a decree conclusively disposing of the issues between DWR and OWID.

- B. THE TRIAL COURT PROPERLY EXERCISED ITS DISCRETION TO DENY DECLARATORY RELIEF AT THIS TIME.
- 1. Declaration Concerning the CPUC and FPC Proceedings (1.b; 1.c).

"A declaratory judgment, like other forms of equitable relief, should be granted only as a matter of judicial discretion, exercised in the public interest. . . . It is always the duty of a court of equity to strike a proper balance between the needs of the plaintiff and the consequences of giving the desired relief. Especially where governmental action is involved, courts should not intervene unless the need for equitable relief is clear, not remote or speculative." *Eccles v. Peoples Bank*, 333 U.S. 426, 431 (1948, citations omitted).

A particular need for judicial restraint has been recognized in cases involving the internal relations of state government, as is true here where the difficulties are between two agencies of the State of California. "The delicacy of that issue and an appropriate regard 'for the rightful independence of state governments'... reemphasize that it is a wise and permissible policy for the federal chancellor to stay his hand in absence of an authoritative and controlling determination by the state tribunals.... For we are here concerned with the much larger issue as to the appropriate relationship between federal and state authorities functioning as a harmonious whole." Chicago v. Fieldcrest Dairies, Inc., 316 U.S. 168, 172-173 (1942).

"In the exercise of this Court's discretionary power to grant or withhold the declaratory judgment remedy it is of controlling significance that it is in the public interest to avoid the needless determination of constitutional questions and the needless obstruction to the domestic policy of the states by forestalling state action in construing and applying its own statutes." Alabama State Federation of Labor v. McAdory, 325 U.S. 450, 471 (1945); see, also, Shipman v. DuPre, 339 U.S. 321 (1950).

These policy considerations militating in favor of dismissal become particularly compelling where, as here, the relief requested would not terminate further litigation. See, Delno v. Market St. Ry. Co., 124 F.2d 965 (9th Cir. 1942, cited by DWR). Clearly the specific determinations of what the encroachment of Oroville Reservoir will be, what it will require to be done, and how it is to be done and paid for could not be made in this action, yet will have to be made before the dispute can come to an end.

In Public Service Commission of Utah v. Wycoff Co., 344 U.S. 237 (1952), plaintiff sought a declaration that it was exempt from state regulation and an injunction against interference by the State Commission, relief substantially the same as that asked here. The Supreme Court held that the action should have been dismissed as premature because

- (1) it was not directed to "any specific order or . . . concrete regulatory step" (p. 244),
- (2) it would serve no "useful purpose" if the state subsequently undertakes regulation of plaintiff (p. 246),
- (3) it would "pre-empt and prejudge issues that are committed for initial decision to an administrative body" (p. 246);
- (4) it would result in an "anticipatory judgment by a federal court to frustrate action by a state agency ... [not] tolerable to our federalism." (p. 247),
- (5) it would improperly convert a federal law defense into an affirmative cause of action. (p. 248).

Each of these grounds applies to this case and compelled dismissal of the action. DWR attempts to distinguish the case on two grounds. It says that in *Wycoff* the Commission had "done nothing to prevent Wycoff from operating

its business, other than to file an injunction action" while here "the FPC and CPUC have held hearings . . . [and] are now considering and are about to render decisions . . ." (O.B. pp. 30-31) The distinction is without a difference because in neither case had there been an order or other administrative action with which the court could deal in a concrete fashion. To the extent there is a distinction, however, it would seem even more inappropriate for the district court here to rush in to "pre-empt and prejudge" the issues while the administrative agencies, which alone can provide the concrete and specific determinations needed to solve the dispute, are deliberating.

DWR's second ground is that in the Wycoff case, the Commission was not necessarily precluded from lawfully taking any regulatory action. (O.B. p. 30) But the same is true here, as even DWR's brief concedes when it says

"Any decision by CPUC . . . which ignores the obligations of OWID under the Federal Power Act . . . would inevitably conflict with any decision of the FPC." (O.B. p. 31, emphasis added)

and

"If the FPC and CPUC reach different . . . conclusions . . ." (O.B. p. 40, emphasis added)

Without considering the merits of DWR's assertions here, it is sufficient to note that the argument plainly recognizes that the validity of DWR's federal law claims and defenses on which this action is based are contingent on the nature and terms of a decision not yet rendered by CPUC. These claims are asserted here prematurely for no one knows what the final order of the CPUC will be and whether it will be in conflict with federal law. DWR has not demonstrated the inevitability of conflict and this Court cannot assume it.

The Wycoff case is of course only one of a number of cases in which the federal courts have rejected efforts such as DWR's effort to "rush into federal court to get a declaration which... is intended... to tie the Commission's hands before it can act..." (344 U.S. at p. 247) Even before Wycoff, the Supreme Court refused to countenance such attempts to circumvent state administrative proceedings. In Petroleum Exploration, Inc. v. Public Service Commission, 304 U.S. 209 (1938), a gas company sought a federal court injunction against proceedings before the Kentucky Public Service Commission to fix the company's rates on the grounds that the proceedings were beyond the Commission's jurisdiction and in violation of the company's constitutional rights. The Court refused to intervene, declaring at pp. 222-23:

"By the process of injunction the federal courts are asked to stop at the threshold, the effort of the Public Service Commission of Kentucky to investigate matters entrusted to its care by a statute of that Commonwealth obviously within the bounds of state authority in many of its provisions. The preservation of the autonomy of the states is fundamental in our constitutional system. The extraordinary powers of injunction should be employed to interfere with the action of the state or the depositaries of its delegated powers. only when it clearly appears that the weight of convenience is upon the side of the protestant. 'Only a case of manifest oppression will justify a federal court in laying such a check upon administrative officers acting colore officii in a conscientious endeavor to fulfill their duty to the state."

And the Court has reaffirmed its disapproval of such "end-run" tactics as DWR here seeks to employ subsequent

to Wycoff. In Public Utilities Commission v. United Air Lines, 346 U.S. 402 (1953), an airline sought federal declaratory relief from regulation by CPUC on the grounds that such regulation was outside the jurisdiction of the Commission and was unconstitutional. The Court, in a per curiam decision, summarily reversed a three-judge federal tribunal which had granted the relief, citing its opinion in Wycoff. See, also, Topp-Cola Company v. Coca-Cola Company, 314 F.2d 124 (2d Cir. 1963), holding at page 126 that an applicant for advantages conferred by local trademark registration laws "may not use a declaratory judgment action in order to remove to a federal court an opposition proceeding before local [administrative] authorities" and Gill v. Iowa-Illinois Gas and Electric Company, 233 F.2d 145 (7th Cir. 1956), affirming dismissal of an action by consumers of electricity, supplied by a public utility, for an injunction against regulation of the utility's rates by the Illinois Commerce Commission and for a declaration that such regulation was exclusively within the jurisdiction of the FPC.

DWR's concurrent request for a declaration of exclusive jurisdiction in the FPC under the Federal Power Act (CT 62) is simply another effort to block the CPUC proceedings and without merit for the reasons already discussed. Gill v. Iowa Gas and Electric Company, above, is squarely in point and establishes that such a declaration would be improper. In that case the plaintiffs asked for a declaration of exclusive FPC jurisdiction, or, in the court's words, "urge[d] the judiciary to correct alleged administrative under-enforcement at the national level, i.e., Federal Power Commission." (233 F.2d 146) The Court denounced this attempted use of the declaratory judgment procedure "as an ignition switch by which to start the machinery of the federal administrative agency", stating at pp. 146-147:

"Utilizing a remedy labeled 'declaratory judgment' adds nothing significant to plaintiffs' abortive effort to short circuit procedural and administrative steps intimately connected with the regulation and supervision of the public utility, Iowa-Illinois . . . We think the district judge correctly declined to indirectly coerce or activate the Federal Power Commission or oust the Illinois Commerce Commission."

In Part II of this brief we show that DWR's arguments respecting FPC jurisdiction are mistaken on the merits. But even if one were to accept, for purposes of discussion, DWR's argument that OWID's alleged violations of Section 10 give FPC jurisdiction to the exclusion of CPUC, it is clear that if the FPC fails to find violations (as we think it must), DWR's entire argument collapses. The Court therefore is being asked to prejudge an issue now properly before administrative agencies and to interfere with state administrative proceedings on the strength of a speculative assumption which may shortly be proved wrong. Such action would be a mistake and is moreover unnecessary for the protection of DWR's rights.

2. Declaration Concerning DWR's Right to Bring Future Lawsuits (1.d; 1.e).

As for the requested declaration that DWR has a right to maintain eminent domain proceedings under Section 21 of the Federal Power Act (CT 63) or ejectment proceedings (CT 64), the complete answer was given by this Court in *United States v. Central Stockholders' Corp. of Vallejo*, 52 F.2d 322 (9th Cir. 1931). There the United States had brought suit to determine that the defendant had no right to prevent the United States and its Federal Power Act licensee from constructing certain reservoirs, and no right to be compensated for loss of water occasioned by the impounding of water by the United States and its licensee.

The Court held that those were nonjusticiable abstract questions, and that if the United States wanted to impound the water, its remedy was to do it. See also, *United States v. West Virginia*, 295 U.S. 463 (1935)*

Declaration Concerning the Effects of Violation of the Federal Power Act (1.a; 1.c).

At virtually every point in its brief DWR refers to the Federal Power Act, particularly Sections 10(a), 10(b) and 10(c), and argues the asserted effects on its obligations to OWID. Its position seems to be that it has no obligations to OWID because OWID violated these provisions (O.B. 26-27) by misrepresenting the effects of the Reservoir and failing to construct the South Fork Project in a manner approved by FPC. (O.B. pp. 22-24, 35-36) Even if DWR's claim of violation were true (which it is not), no authority is cited for the proposition that DWR can therefore destroy OWID's facilities with impunity, and we know of no such authority.

For reasons which are not disclosed anywhere in its brief, DWR has attached to its brief the initial decision of an FPC examiner. Not being a part of the record, the initial decision manifestly is not properly before the Court. Moreover, it certainly does not demonstrate FPC support for DWR's legal or factual substantive position. It is nothing more than a recommendation to the FPC, which alone can make a decision; exceptions will be filed to this recommendation which will demonstrate its error in many important respects. What the initial decision does show vividly is that DWR asked the court below, and now asks this Court, to pre-empt and prejudge complex factual issues presently before administrative tribunals. In short, it underscores the

^{*}Central Stockholders was decided before the Declaratory Judgment Act, West Virginia after adoption of the Act.

impropriety of federal court intervention at this juncture, as does DWR's own request here for a *stay* of further proceedings until a final FPC decision has been rendered. (O.B. p. 53)

DWR's substantive contentions, even if valid, are in any event, in the nature of *defenses* to OWID's claim before the CPUC, as is clearly shown by DWR's brief. (O.B. pp. 20, 25, 28, 33 and 36) The existence of defenses arising under federal law does not, however, create an affirmative cause of action for relief:

"Respondent here has sought to ward off possible action of the petitioners by seeking a declaratory judgment to the effect that he will have a good defense when and if that cause of action is asserted. Where the complaint in an action for declaratory judgment seeks in essence to assert a defense to an impending or threatened state court action, it is the character of the threatened action, and not of the defense, which will determine whether there is federal-question jurisdiction in the District Court. If the cause of action, which the declaratory defendant threatens to assert, does not itself involve a claim under federal law, it is doubtful if a federal court may entertain an action for a declaratory judgment establishing a defense to that claim. This is dubious even though the declaratory complaint sets forth a claim of federal right, if that right is in reality in the nature of a defense to a threatened cause of action. Federal courts will not seize litigations from state courts merely because one, normally a defendant, goes to federal court to begin his federal-law defense before the state court begins the case under state law." Public Service Commission of Utah v. Wycoff Co., 344 U.S. 237, 248 (1952), emphasis added; see, also, Skelly Oil Co. v. Phillips Co., 339 U.S. 667, 671-674 (1950); Bonanza Airlines, Inc. v. Public Service Commission, 186 F.Supp. 674, 679 (D.Nev. 1960); Arrow Lakes Dairy, Inc. v. Gill, 200 F.Supp. 729, 731-732 (D. Conn. 1961).

4. Declaration Concerning the Future Effects of DWR's Reservoir (1.d).

Finally, DWR's request for a declaration that it "will not take or damage any lands or property belonging to [OWID]" (CT 63) is so far beyond the pale as to require no comment.

The federal courts will not—and constitutionally cannot -issue declarations which are abstract or hypothetical, and hence premature. The power to grant declaratory relief is limited to a "concrete case admitting of an immediate and definitive determination of the legal rights of the parties." Public Service Commission of Utah v. Wycoff Co., above, at p. 243. This is not such a case. As has been shown above, the court could not make a blanket declaration of nonliability without regard to what the circumstances may be in which DWR takes or damages OWID's property. It cannot make an abstract declaration of DWR's right to maintain and prevail in other lawsuits, without regard to what facts might be proved in such suits. It certainly cannot declare that DWR's project will not cause injury to OWID's property. The declaratory judgment act gives the court no power to issue predictions of future facts. See 28 U.S.C. § 2201; United States v. West Virginia, above; Fair v. Dekle, 367 F.2d 377 (5th Cir. 1966), cert. denied, 386 U.S. 996 (1967)

II. Sections 11590-11592 of the Water Code Are Valid and Vest CPUC With Jurisdiction Over Certain Phases of the Dispute Between the Parties

A. DWR'S ARGUMENTS ON THE MERITS OF ITS "FEDERAL LAW CLAIMS" ARE IRRELEVANT AND PREMATURE

The only issue which is properly before this Court is whether the judgment below can be sustained on any ground. See, *Jaffke v. Dunham*, 352 U.S. 280, 281 (1957). We have shown above why it should be sustained on the ground on

which the judgment was rendered. But even if this Court were to reach the merits of DWR's attack on W.C. Sections 11590-11592 and CPUC jurisdiction, the judgment has to be sustained unless, regardless of the facts and *under any construction or application*, Sections 11590-11592 must be struck down and the CPUC held to be without jurisdiction.

As a general proposition, federal courts will not go out of their way to strike down state statutes as invalid. Such action is, and should be, a last resort only. If a statute can be interpreted in a way which will render it valid, it should be given such an interpretation.

"If an interpretation of a state statute can be reasonably adopted which does not bring the enactment within the inhibition of federal law, that interpretation should prevail against another which would rest upon an assumption that the state legislature intended to enact a law in conflict with the constitution or statutes of the United States." Rushton v. Schram, 143 F.2d 554, 559 (6th Cir. 1944); accord, Associated Press v. National Labor Relations Board, 301 U.S. 103, 132 (1937).

This principle ought to be of particular force where the attack on the statute is made before the factual record has been developed before the administrative agency and the agency has had an opportunity to interpret the statute. (In this connection, see the discussion respecting prematurity, Part I, above). Moreover, DWR's standing to attack the validity of the very statute from which it derives its existence is subject to substantial doubt. See, Heim v. McCall, 239 U.S. 175, 190 (1915).

B. DWR'S ARGUMENTS ON THE MERITS ARE ERRONEOUS

In any event, examination of the Federal Power Act and the California Water Code discloses that the former does not intrude into the area of the latter and that there is no conflict between them, at least so far as this case is concerned. While Sections 10(a), 10(b) and 10(c) of the Act give the FPC power to require modifications before approval of a project, to approve modifications subsequently and to require a licensee to maintain its project, Section 10(c) also provides that

"Each licensee hereunder shall be liable for all damages occasioned to the property of others by the construction, maintenance, or operation of the project works..."*

When FPC issued its license to DWR for the Oroville project, in 1956 and again in 1957, it specifically noted the possibility of damage being caused to OWID's Miners Ranch Canal and gave DWR notice that "the provisions of Section 10(c) of the act make each licensee liable for all damages occasioned to the property of others..." (16 FPC at pp. 1340-1341).

The effect of Section 10 (c), and of the proviso in DWR's license, is to preserve such liability as exists under general law and to preclude creation of immunity in a licensee.

Clearly, one whose reservoir impairs or destroys another's property would, under general principles of law, be liable to that person. Section 10(c) simply confirms that this liability survives issuance of the license. See, Ford & Son v. Little Falls Fibre Co., 280 U.S. 369 (1930).

That is what OWID is concerned with in the CPUC proceedings. It is an irrigation district responsible for supplying essential domestic and irrigation water to some 15,000 people and 5,000 acres in Butte County. Its South Fork Project is a part of the California Water Plan, carried out under DWR's aegis. (DWR Bulletin 3, May 1957, p. 108,

^{*}DWR's brief studiously omits any reference to this provision.

plate 5 sheet 6, CT 159) After many years of cooperative and coordinated effort with DWR in the development of the Feather River water resources, it was suddenly faced with a repudiation by DWR of responsibility for the consequences of Oroville Reservoir in May 1966. (CT 75) To protect the interests of the local water users which it serves, the application was then filed with the CPUC to resolve this question of responsibility.

The Federal Power Act does not deal with this kind of problem. It does not provide a remedy. It does not confer jurisdiction on FPC to determine questions of liability for damage done by a licensee, and it does not preclude state tribunals such as CPUC from hearing and determining such questions. The FPC itself has always held that tribunals other than itself possessed jurisdiction to adjudicate liability issues. Alabama Power Co., 58 P.U.R. 3rd 407, 410 (1965); Idaho Power Co., 29 F.P.C. 29 (1963); Department of Water Resources, 28 F.P.C. 3, 4 (1962). Since the Ford case, above, it has not been questioned that state tribunals have at least concurrent jurisdiction.

State jurisdiction of compensation questions, and the application of state rules to such questions, is certainly not abhorrent to the Act. An unbroken line of authority holds that state laws fixing the amount of money an FPC licensee must pay to those with whose property it interferes are valid and binding upon the licensee. See, Feltz v. Central Nebraska Public Power & Irrigation District, 124 F.2d 578 (8th Cir. 1942) (state law determines the amount of consequential damages licensee must pay upon taking property); United States v. Central Stockholders' Corp. of Vallejo, 52 F.2d 322 (9th Cir. 1931) (licensee must pay riparians damage caused by its diverting water because state law so provides); Ford & Son v. Little Falls Fibre Co., 280 U.S.

369 (1930) (same); Central Nebraska Public Power & Irrigation District v. Fairchild, 126 F.2d 302 (8th Cir. 1942) (state law determines the amount of interest payable by licensee upon taking property, even though it imposes greater burdens on licensee than general law respecting interest).*

Indeed, Section 21 of the Act specifically contemplates that the amount payable by a licensee for property taken or destroyed may be fixed in the first instance by contract—which would be governed by state law. It further provides that even in the event of a taking by eminent domain, a condemnation action may be brought in the state court and, even if it is not brought there, the practice and procedure shall conform as nearly as possible with that in the state courts. 16 U.S.C. § 814. With respect to the liability of a licensee to provide substitute or relocated facilities for those which it takes or destroys, the Act leaves that subject untouched. See, Feltz v. Central Nebraska Public Power & Irrigation District, above, at p. 582.

There is, therefore no reason to assume that Congress meant to preclude anyone injured by a licensee's activities from recovering damages by action in a state tribunal. There is also no reason to suppose that Congress meant to single out damaged licensees and deprive them alone of the right enjoyed by others to recover for the damages done to them by other licensees. And there is certainly no reason to assume that Congress meant to oust state utilities commissions from jurisdiction, particularly where the question of liability transcends a private dispute and is between two state agencies responsible for the protection of the important public interest in an uninterrupted water supply.

^{*}See also Broad River Power Co. v. Query, 288 U.S. 178 (1933), which provides that a state may tax the production of power by an FPC licensee.

That conclusion is not changed by the fact that W.C. Sections 11590-11592 contemplate the provision of substitute facilities—this being the measure of damages under general law in the type of cases covered by Section 11590. See, e.g., State of Washington v. United States, 214 F.2d 33, 39 (9th Cir. 1954), cert. den. 348 U.S. 862 (1954).

DWR argues, however, that provision of substitute facilities may involve modification of licensed project works. If it does, it is of course subject to prior approval of FPC. This is the position consistently taken by OWID (CT 167-168) and accepted by CPUC. (CT 282) It was also the thrust of this Court's order of September 11, 1967, denying DWR's motion for a restraining order as unnecessary. But Section 10(b) only provides that FPC approval must be obtained before substantial modifications are made. It does not give FPC, as DWR argues, exclusive jurisdiction to "require" modifications now (O.B. p. 36), much less to adjudicate liability.* It certainly does not prohibit another tribunal from awarding damages which may involve the making of modifications, so long as FPC approval is obtained before they are made. And it certainly does not clothe DWR in immunity for damage it may do (as it contends here) or prohibit other tribunals from allocating liability for the adverse consequences of a licensee's activities, particularly where the allocation is between two state agencies. In other words, even assuming that the Act imposes some limitations on CPUC jurisdiction, it cannot be said that CPUC is totally lacking in any jurisdiction what-

^{*}In fact, the FPC's jurisdiction is circumscribed by the Act which prohibits it from altering outstanding licenses without the licensee's consent (Sec. 6) and authorizes it to require modification of project works only before the project has been approved. (Sec. 10(a))

ever touching the problem and accordingly the requested relief, which would oust it completely, was properly denied.

DWR's only authority is First Iowa Hydro-Electric Cooperative v. FPC, 328 U.S. 152 (1946), said to establish FPC's "comprehensive and exclusive jurisdiction . . . over the planning, financing and construction of projects . . ." (O.B. p. 33) But that case only held that Section 9 (b) of the Act, requiring an applicant to submit with its application to the FPC satisfactory evidence of compliance with state law, did not require FPC to refuse issuance of a license until the applicant had obtained a state permit for the project as required by state law in that case. That the Court was concerned solely with the validity of state laws which give state officials a veto power over federally licensed projects is abundantly clear from the opinion:

"To require the petitioner to secure the actual grant to it of a state permit under § 7767 as a condition precedent to securing a federal license for the same project under the Federal Power Act would vest in the Executive Council of Iowa a veto power over the federal project. Such a veto power easily could destroy the effectiveness of the Federal Act. It would subordinate to the control of the State the 'comprehensive' planning which the Act provides shall depend upon the judgment of the Federal Power Commission or other representatives of the Federal Government. * * * In the Federal Power Act there is a separation of those subjects which remain under the jurisdiction of the States from those subjects which the Constitution delegates to the United States and over which Congress vests the Federal Power Commission with authority to act. To the extent of this separation, the Act establishes a dual system of control. The duality of control consists merely of the division of the common enterprise between two cooperating agencies of government, each with final authority in its own jurisdiction. The duality does not require two agencies to share in the final decision of the same issue. Where the Federal Government supersedes the state government there is no suggestion that the two agencies both shall have final authority. * * * A dual final authority, with a duplicate system of state permits and federal licenses required for each project, would be unworkable." (328 U.S. 152 at pp. 164, 167-168, emphasis added.)

Sections 11590-11592 do not, of course, give state officials a veto power over DWR's project and are not intended to do so. They do not interfere with the carrying out of a federally licensed project, and no relief threatening such interference is sought under them. The CPUC has construed them as not conflicting with the Federal Act. See, Feather River Railway Co., 61 P.U.C. 728 (1963), writ of review denied, August 12, 1964; County of Butte, 62 P.U.C. 537 (1964), writ of review denied, March 1965. DWR asks this Court, contrary to precedent and common sense, to assume that conflicting orders are likely to be issued, although such orders are neither sought nor necessary. Rushton v. Schram, 143 F.2d 554 (6th Cir. 1944); Erlich v. Municipal Court, 360 P.2d 334, 55 C.2d 553, 558 (1961); Hughes v. City of Lincoln, 43 Cal. Rptr. 306, 232 C.A.2d 741, 749 (1965).

The First Iowa case recognizes the existence of a dual system of control under the Act, leaving certain subjects to control by the states. (See pp. 20-21, above) One of those subjects in which state law has traditionally controlled, as pointed out above, is the determination of liability for damage done by a licensee to the property of others. DWR's brief will be read in vain for any demonstration why it follows that the existence of FPC jurisdiction under Sections 10(a), 10(b) or 10(c) compels the conclusion that no

valid CPUC order can be made in this case.* Quite the contrary, a reading of these statutes and the cases demonstrates that this is one of those common situations where federal and state jurisdiction can and should be accommodated. Certainly the Court should be slow to impute to Congress an intention to prevent the exercise of state power in a matter of serious public concern where no authority is given to the federal agency to meet the need, i.e., allocating the burden of damage caused by DWR's project. Atchison, T. & S. F. Ry. Co. v. Railroad Commission, 283 U.S. 380, 391 (1931) (where the state commission ordered relocation of rail lines subject to the necessary approval of the Interstate Commerce Commission, showing that, DWR's argument notwithstanding, conflict between state and federal orders is not inevitable).

III. DWR Is Not Entitled to Injunctive Relief.

All that has been said to this point applies equally to refute DWR's claim to injunctive relief; that claim is made prematurely (Part I) and is substantively without merit (Part II). The claim appears to be based on the contention that there is a

"potential source of conflict that could result from independent decisions of the FPC and CPUC." (O.B. p. 44)†

It is self-evident that this is not a sufficient ground to enjoin the operation of a state statute and the proceedings

^{*}The most DWR seems to say is that there is a "potential source of conflict that could result from independent decisions of the FPC and CPUC". (O.B. p. 44) This argument demonstrates that the action is premature and it is certainly insufficient to strike down a state statute. (See Parts I and III) Moreover, as pointed out above, DWR's argument assumes that OWID modified its Canal and constructed it without FPC approval (O.B. pp. 36, 38), and these facts are disputed and for the administrative agencies to determine.

[†]Compare the ground urged by DWR in support of its requests for an injunction below, namely, that the federal act supersedes and preempts Sections 11590-11592. (CT 354, 495)

of a state agency, even if the arguments of Parts I and II, above, were ignored.

To begin with, the claim is wholly lacking in equity because DWR has not shown "any threatened or probable act of the [appellees] which might cause the irreparable injury essential to equitable relief by injunction." Public Service Commission of Utah v. Wycoff Co., above at p. 241.

Neither OWID nor CPUC has threatened, or contemplates, any action whatever that might in any way interfere with DWR's project. OWID is merely pursuing its remedy to secure relief for the damage with which its project is threatened by DWR. It does not oppose any taking or other action connected with DWR's project. The CPUC has taken the same position in this proceeding. (CT 112) Hence there is not even an issue or controversy, let alone threatened injury, respecting DWR's right to carry out its project and to take whatever property or action it needs for the purpose. There is, therefore, no threat of irreparable injury to DWR, much less an imminent one, and no right to an injunction.*

United States v. West Virginia, 295 U.S. 463 (1935) so holds. In that case, the United States brought suit to enjoin a state from asserting that its right to license a particular power project was superior to the United States' right to do so, and for a declaration that the United States' right was in fact superior. There was "no allegation of any interference by the State, actual or threatened, with any of the land or property" the United States had acquired

^{*}It has long been settled that the expense and inconvenience of litigation are not the kinds of irreparable harm against which equity protects. Myers v. Bethlehem Shipbuilding Corp., 303 U.S. 41, 51-52 (1938). See, also, Macauley v. Waterman Steamship Corp., 327 U.S. 540, 544-545 (1946), to the effect that questions of statutory coverage are not to be decided by injunction suits when the administrative process "had hardly begun."

for the project. (p. 471) The Supreme Court denied relief, and, further, held that those facts did not state a justiciable case or controversy. See also *New York v. Illinois and Sanitary District of Chicago*, 274 U.S. 488 (1927) (no right to enjoin diversion of water absent a showing that existing project will be affected by it).

Moreover, DWR's remedies in pending proceedings before PUC and FPC are adequate. DWR has asserted its defenses there and, if necessary, can appeal any adverse final orders.

"The procedures of review usually afford ample protection to a carrier whose federal rights are actually invaded, and there are remedies for threatened irreparable injuries. State courts are bound equally with the federal courts by the Federal Constitution and laws. Ultimate recourse may be had to this Court by certiorari if a state court has allegedly denied a federal right." Public Service Commission of Utah v. Wycoff Co., supra, pp. 247-248.

DWR's appeal for injunctive relief, based on the opposite premise (O.B. p. 41-42), is therefore groundless. See also, Great Lakes Dredge & Dock Co. v. Huffman, 319 U.S. 293 (1943); Toomer v. Witsell, 334 U.S. 385 (1948).

The cases DWR cites to support its claim for injunction do not help it in the slightest and demonstrate the lack of equity of its case. (O.B. pp. 45-47)

In Chicago v. Atchison, T. & S. F. Ry. Co., 357 U.S. 77 (1958), the interstate railroads had engaged a motor carrier to transfer their interstate passengers and baggage between railroad stations in Chicago. The City then adopted an ordinance prohibiting the carrier from operating unless it first obtained a city certificate and approval of the City Council. When the carrier refused to do so, the City threatened to arrest and fine its drivers for operating

without a certificate. The Court held that the movement of passengers and baggage between these stations was interstate commerce, that the city ordinance was invalid insofar as it prohibited such transfers without a city certificate and that the carrier was entitled to relief against the city's enforcement efforts by threats of arrests and fines.

Cloverleaf Co. v. Patterson, 315 U.S. 148 (1942), held that an injunction would lie against state officials who on sixteen occasions entered plaintiff's plant and under state pure food laws seized twenty thousand pounds of packing stock butter from which plaintiff manufactured renovated butter, jeopardizing plaintiff's ability to continue in business. Plaintiff held the stock for manufacture into renovated butter to be shipped in interstate commerce. The Court held that since federal legislation covered the production of this product for shipment in interstate commerce, state officials could not confiscate a product which met Federal requirements and thereby interfere with, indeed prohibit, interstate commerce.

In Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947), proceedings were brought before the Illinois Commerce Commission to regulate warehousemen under the state regulatory law. The Court found that certain phases of that regulation, including rate regulation and licensing requirements, were covered by the federal act and that Congress in these respects had unequivocally provided federal regulation to be exclusive. It specifically distinguished instances of dual control by state and federal authorities, citing the First Iowa case, above. Other phases of the state regulatory scheme were not covered by the federal act. As to these the court said:

"Any such objections are at this stage premature. Congress has not foreclosed state action by adopting a policy of its own on these matters. Into these fields it has not moved. By nothing that it has done has it preempted those areas. And see *Federal Compress Co. v. McLean, supra,* p. 23. In more ambiguous situations than this we have refused to hold that state regulation was superseded by a federal law." (331 U.S. 218 at p. 237)

These cases hold that only when there is a direct, explicit and immediate conflict in the exercise of state and federal power, resulting in immediate interference with federally protected activities or violation of the congressional mandate, will the federal court enjoin state action. Nothing of the sort exists in this case. All CPUC is undertaking is to allocate responsibility for damage as between state agencies, subject to whatever federal approvals may be required subsequently (essentially a matter of determining which pocket of the state is to pay for consequences of a reservoir). There is no threat of interference with federally authorized activities or even of curtailing any of DWR's rights or remedies.

In the court below DWR relied also on the companion case to Rice, above, Rice v. Board of Trade of the City of Chicago, 331 U.S. 247 (1947). This time it fails to cite it although it is most instructive in determining the reach of the foregoing cases. In that case, the Court upheld a denial of injunctive relief against enforcement by the Illinois Commerce Commission of state laws applicable to the Board of Trade. After noting that the federal Commodity Exchange Act contains no declaration ousting state jurisdiction, it held (unanimously):

"Respondents' claim of supersedure is, therefore, premature. Until it is known what rules the Illinois Commission will approve or adopt, it cannot be known whether there will be any conflict with the federal law. Any claim of supersedure can be preserved in the state proceedings. And the question of supersedure can be determined in light of the impact of a specific order of the state agency on the Federal Act or the regulations of the Secretary thereunder. Only if that procedure is followed can there be preserved intact the whole state domain which in actuality functions harmoniously with the federal system. For even action which seems pregnant with possibilities of conflict may, as consummated, be wholly barren of it." (331 U.S. 247 at pp. 255-256; emphasis added)

That statement controls here. Moreover, the granting of injunctive relief lies in the discretion of the trial court and in these circumstances it cannot be said that this discretion was not properly exercised. See, Yakus v. United States, 321 U.S. 414, 440 (1944); United States v. W. T. Grant Co., 345 U.S. 629, 634-636 (1953); Rice & Adams Corp. v. Lathrop, 278 U.S. 509, 514 (1929). And contrary to DWR's assertion (O.B. p. 49) and unlike Stein v. Oshinsky, 348 F.2d 999 (2nd Cir. 1965), cert. denied 382 U.S. 957 (1965) on which DWR relies, DWR's claim for injunctive relief does rest on disputed facts (see pp. 15, 25, above) which OWID has had no opportunity to meet, and it cannot therefore be adjudicted here as DWR requests. (O.B. pp. 49, 53)

IV. Comity Requires That the Judgment Below Be Sustained.

There are additional considerations supporting the judgment below. It is settled law that in the absence of compelling circumstances, the federal courts will not interfere with pending state administrative proceedings.* Alabama Public Service Commission v. Southern Ry. Co., 341 U.S. 341 (1951):

^{*}Comity is to be distinguished from abstention referred to by DWR in its brief here and below, which rests on different principles.

"As adequate state court review of an administrative order based upon predominantly local factors is available to appellee, intervention of a federal court is not necessary for the protection of federal rights. Equitable relief may be granted only when the District Court, in its sound discretion exercised with the 'scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts,' is convinced that the asserted federal right cannot be preserved except by granting the 'extraordinary relief of an injunction in the federal courts.' Considering that '[f]ew public interests have a higher claim upon the discretion of a federal chancellor than the avoidance of needless friction with state policies,' the usual rule of comity must govern the exercise of equitable jurisdiction by the District Court in this case. Whatever rights appellee may have are to be pursued through the state courts." (Pp. 349-350, citations omitted, emphasis added)

Alabama Public Service Commission was followed in Martin v. Creasy, 360 U.S. 219 (1959); Florida R.R. and Public Utilities Commission v. Atlantic Coast Line R.R. Co., 342 U.S. 844 (1951) (Memorandum decision), and Atlantic Coast Line R.R. Co. v. City of St. Petersburg, 42 F.2d 613 (5th Cir. 1957). See also Great Lakes Dredge & Dock Co. v. Huffman, 319 U.S. 293, 298 (1943).

If noninterference is the prevailing principle in the usual ase, this is the *a fortiori* case for its application for, notvithstanding the presence of federal issues, the meat of it learly involves local questions: how best to ensure a coninuing water supply to local users, and which of two State gencies ought to pay to provide or relocate the needed acilities. (See pp. 1-3, 19-20, above)

The question of how to supply the local water users is in act classically a local one. Trenton v. New Jersey, 262 U.S.

182, 185 (1923) (state has power and duty to control and conserve its water resources for the benefit of all its inhabitants). Section 28 of the Act reaffirms the local nature of this matter by declaring that "Nothing contained in this chapter [§§ 791a-793, 795-797, 798-818, and 820-825r of this title] shall be construed as affecting or intending to affect or in any way to interfere with the laws of the respective States relating to the control, appropriation, use, or distribution of water used in irrigation or for municipal or other uses, or any vested right acquired therein."*

For that reason alone this Court should not interfere or direct the lower court to interfere with the local agency's attempt to resolve it. In Alabama Public Service Commission v. Southern Ry. Co., above, for example, the Supreme Court held that a federal court should not take jurisdiction to enjoin a State Public Utilities Commission from enforcing an order prohibiting the abandonment of intrastate tracks, emphasizing that this involved the "essentially local problem" of balancing the cost to the railroad against the public need in local towns. Similarly, in Burford v. Sun Oil Co., 319 U.S. 315 (1943), the Supreme Court held that a

^{*}In addition, special circumstances exist in this case which make it particularly appropriate for the court to let the CPUC determine the application. OWID is the successor of two public utility water companies (South Federal Land and Water Company and Palermo Land and Water Company). When it acquired the systems of these companies, the CPUC issued orders requiring it to continue to serve water users in their former service areas, and these orders were upheld by the California Supreme Court. Henderson v. Oroville-Wyandotte Irrigation District, 277 Pac. 487, 207 Cal. 215 (1929); Henderson v. Oroville-Wyandotte Irrigation District, 2 P.2d 803, 213 Cal. 514 (1931); Rutherford v. Oroville-Wyandotte Irrigation District, 8 P.2d 836, 215 Cal. 124 (1932), cert. denied 287 U.S. 609 (1932). DWR's overall plan for development of the area's water resources contemplated that a substantial portion of the area would be served by OWID through Miners Ranch Canal. (CT 159) Impairment or destruction of the Canal would make it impossible for OWID to comply with the service requirements of CPUC's orders. Thus it is most appropriate for CPUC to continue to concern itself with this matter.

dederal court should not take jurisdiction to enjoin enforcement of a Commission's order granting a right to drill oil wells in Texas, because the oil industry was of great mportance to the local economy. See also, *Hawks v. Hamill*, 288 U.S. 52 (1933).

The issue between DWR and OWID is even more narowly local than that respecting distribution of water, inrastate transportation, or Texas oil wells. The issue is imply which of these two state agencies should bear reponsibility for damage to OWID's facilities caused by OWR. State agencies are merely creatures of the state, nd the state can take money from them, or tax them, without any inhibition by federal law. See Trenton v. New Jersey, above; Pawhuska v. Pawhuska Oil & Gas Co., 250 U.S. 394 (1919); Hunter v. Pittsburgh, 207 U.S. 61 (1907); City of Coronado v. San Diego Unified Port District, 227 C.A.2d 455, 477-478 (1964) appeal dismissed, 80 U.S. 125 (1965); Cranford Co. v. City of New York, 8 F.2d 52 (2d Cir. 1930). Indeed, state agencies hold heir property for the benefit of all the people of the state, nd, therefore, the question of who pays for the relocation r replacement of such property is a matter of local bookeeping. Fletcher v. Mapes, 62 F.Supp. 351, 353 (N.D. Cal. 945); County of Marin v. Superior Court, 53 C.2d 633, 638-39 (1960); Reclamation District v. Superior Court, 171 cal. 672, 680 (1916).

Federal courts will not even adjudicate interagency disputes between federal agencies. *United States v. Easement and Right of Way*, 204 F.Supp. 837 (E.D. Tenn. 1962). That was an action brought by the TVA to condemn interests in land, including a security interest held by the FHA. The court dismissed the action, holding that the plaintiff and the defendant were the same person, i.e., the United States,

and that the settlement of interagency problems of the United States Government was not a judicial function. See, also, *The Pietro Campanella*, 47 F.Supp. 374, 378-379 (D. Md. 1942), holding that the federal Alien Property Custodian could not be substituted for the Italian owners of two Italian cargo ships in wartime forfeiture proceedings brought by the United States because, *inter alia*:

"... the situation thus created would make a case impossible for the court to adjudicate. The plaintiff is the United States, and the defendant claimant would be an officer of the United States acting for, on behalf of and in the interest of the United States. Obviously there would be no adverse interests here involved and any adjudication made by the court between these two parties would be a nullity." (47 F.Supp. 379)

A fortiori, federal courts cannot (and should not) adjudicate disputes between state agencies, particularly when such an adjudication would foreclose the procedure established by the state legislature for resolving such disputes. See, People v. Sanitary District of Chicago, 71 N.E. 334 (Ill. 1904), holding that the State of Illinois was not a necessary or proper party to a condemnation proceeding brought by its agency, the sanitary district, because, among other reasons:

"...It would be anomalous that the state, which, through its agent, the sanitary canal, desires to devote certain state property to a public use, should by its agent bring a suit in a state court against itself to determine its own compensation for its own land, devoted to its own use. In the absence of express authority for such proceeding—and none exists—it would be a mere nullity, and would be as valid without as with parties thereto." (71 N.E. 335)

In fact, a federal court will not exercise jurisdiction to control the internal affairs of a *private* state-created corpora-

tion. Certainly, it should not when the corporation is not only state-created but also is *public* and an agent of the state. See *Pennsylvania v. Williams*, 294 U.S. 176 (1935):

"It has long been accepted practice for the federal courts to relinquish their jurisdiction in favor of the state courts, where its exercise would involve control of or interference with the internal affairs of a domestic corporation of the state." (294 U.S. 185)

Squarely in point is the unreported decision of the court pelow in State of California v. Certain Designated Roads n Butte County, et al., No. 8744 (N.D. Calif. 1964) (CT 22-224).* That was another action brought by DWR to void its obligations under Section 11590, in that case to replace county roads. That action, like this one, was in he court's words, "the outgrowth of a dispute between a tate and a political agency of the State, concerning proprty held in trust by the agency for the State pursuant to State law, which prescribes a procedure for settling the ispute. See Calif. Water Code §§ 11590 and 11592." The ourt refused to resolve that interagency dispute and disnissed the action. The same result is called for in this case. The present dispute is essentially over which pocket of he state will have to pay for damage done by DWR's ctivities, and that is a proper subject of concern for he state legislature. In Sections 11590-11592 it has dealt with it. Under settled principles of law, this Court should ot interfere with the provisions so made by the legislature or dealing with the state's internal problems.

^{*}That decision is still good law, notwithstanding the fact that DWR apparently settled that case and obtained a stipulated order rom the Court of Appeals dismissing the case as moot. (CT 317)

V. DWR's Procedural Objections Are Without Merit.

DWR contends that the trial court's opinion was faulty because it failed to make findings which would make clear that DWR could assert its Federal Power Act "claims"—more properly defenses (supra, p. 16) — before there is damage to the Canal (O.B. pp. 17, 51). Since the judgmen appealed from granted appellees' motions to dismiss made under Rule 12 of the Federal Rules of Civil Procedure (CT 491-492), no findings of fact at all were required to be made. See, Rule 52(a). In any case, a fair reading of the decision shows that it was based on a broad appreciation of the limits of federal judicial power, as reflected in the Wycoff case, and was not confined to holding that the absence of physical damage alone precluded relief. (Cf. O.B pp. 17, 21)

Moreover, the District Court went out of its way to se at rest the concerns voiced by DWR on this appeal by stating "that the dismissal of this case is predicated exclusively on the ground that the action has been brought prematurely. Nothing said in this memorandum and order is ever to be construed as in any fashion passing upon the right of any appropriate party in the proper forum to seek relief and/or recover damages—should the situation which [DWR] now asserts may happen, does in fact at some time in the future happen." (CT 445-446)

It is clear therefore that the judgment would not preclude DWR from bringing an action based on a different state of facts—and, inevitably, any state of facts in an action hereafter filed will be different from that alleged in the instant action.

This is all the protection DWR can reasonably ask from this Court or the court below.

CONCLUSION

For the reasons stated, the judgment should be affirmed. Dated April 19, 1968.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this lef, I have examined Rules 18, 19 and 39 of the United lates Court of Appeals for the Ninth Circuit, and that, my opinion, the foregoing brief is in full compliance with lose rules.

WILLIAM W SCHWARZER



In the

United States Court of Appeals

For the Ninth Circuit

THE STATE OF CALIFORNIA, Acting by and through the Department of Water Resources,

Appellant,

VS.

THE OROVILLE-WYANDOTTE IRRIGATION DISTRICT, an irrigation district, and the California Public Utilities Commission, a public commission,

Appellees.

Brief of Appellee California Public Utilities Commission

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In the

United States Court of Appeals

For the Ninth Circuit

THE STATE OF CALIFORNIA, Acting by and through the DEPARTMENT OF WATER RESOURCES,

Appellant,

VS.

THE OROVILLE-WYANDOTTE IRRIGATION DISTRICT, an irrigation district, and the California Public Utilities Commission, a public commission,

Appellees.

Brief of Appellee California Public Utilities Commission

STATEMENT OF THE CASE

On October 14, 1966, appellee-Oroville-Wyandotte Irrigation District (OWID) filed an application (Ex. C. to DWR First Amended Complaint, CT 68-72) before the Appellee-California Public Utilities Commission (CPUC) pursuant to Sections 11590-11592 of the California Water Code in which it sought a determination of the obligation, if any, of the Department of Water Resources (DWR), an agency

of the State of California, with respect to the replacemen or relocation of OWID's facilities to be taken or destroye by DWR in the course of the latter's development of th Feather River Project in California. DWR moved to dis miss OWID's application (CT 88-102), which the CPU denied by order on March 28, 1967 (CT 281-284). Hearing were thereafter held by CPUC on OWID's application, by no final determination has been made as of this date by CPUC.

Even prior to CPUC's order denying DWR's motion DWR commenced the instant action in the United State District Court in which it sought to restrain CPUC from proceeding to entertain OWID's application, and to obtain a declaration that CPUC had no jurisdiction over the subject of OWID's application. CPUC and OWID move to dismiss this action in the Court below and DWR file motions for summary judgment and additional injunctive relief. The District Court denied DWR's motion for injunctive relief and granted the motions to dismis Further motions by DWR to enjoin CPUC hearing pending the instant appeal were denied by the Distri Court and this Court.

SUMMARY OF THE ARGUMENT

CPUC believes that it, as a constitutional and statutor agency of the State of California, has an obligation are duty to proceed and hear OWID's application and render determination thereon pursuant to Sections 11590-1159 of the California Water Code. CPUC also believes the there is no conflict between said Sections 11590-11592 are OWID's application thereunder, and any provision of the Federal Power Act. CPUC also urges that DWR's active

of the court below was and is premature since CPUC has not made any final determination adverse to DWR and not DWR has plain, adequate and speedy remedies at law of review any final determination of CPUC. Additionally, considerations of comity, as well as the possible bar of the Eleventh Amendment, require that there be no interference with the CPUC proceeding by the federal courts prior of a final state administrative and judicial determination in the CPUC proceeding.

ARGUMENT

CPUC Has a Duty to Proceed to Hear and Determine OWID's Application; Therefore, the District Court Properly Granted Appellees' Motion to Dismiss.

Article XII, Section 23 of the California Constitution rovides in part:

"... (CPUC) shall have and exercise such power and jurisdiction to supervise and regulate public utilities, in the State of California, and to fix the rates to be charged for commodities furnished, or services rendered by public utilities as shall be conferred upon it by the Legislature, and the right of the Legislature to confer powers upon the (CPUC) respecting public utilities is hereby declared to be plenary and to be unlimited by any provision of this Constitution..."

The California Legislature has enacted Sections 11590, 591 and 11592 of the Water Code of the State of alifornia, which delegate to the Commission the authority adduty to make a determination of the obligation, if any, DWR, an agency of the State of California, to replace relocate the facilities of another state agency or public cility taken or damaged by DWR in the development of the of its projects. This is a duty delegated to CPUC which

no other California or federal agency can perform for it. OWID has filed an application pursuant to said Sections 11590-11592 and CPUC is thus under a duty and should be allowed to proceed to make the determination contemplated by the California Legislature.

There is no basis alleged, or in fact, for the District Court (or this Court) to have restrained the CPUC proceeding. DWR has not shown "any threatened or probable act of the (appellees) which might cause the irreparable injury essential to equitable relief by injunction." (Public Serv. Comm. v. Wycoff, 344 U.S. 237, 241.) A court of equity will not enjoin the mere holding of an administrative hearing. (Railroad Commission of Texas v. Pullman Co., 312 U.S. 496; McDevitt v. Gunn, 182 F. Supp. 335; Reinick v. Loper, 77 F. Supp. 333.)

CPUC does not threaten any action that would interfere with DWR's Feather River Project. Its proceeding to make a determination on OWID's application is a lawful exercise of its jurisdiction and does not conflict with any other law.

There Is No Conflict Between the CPUC Proceeding and any Provision of the Federal Power Act.

Sections 11590-11592 of the California Water Code are part of a statutory scheme which also provides for the existence of DWR. These sections are intended to protect other state agencies and local state utilities, and those citizens dependent on their services, affected in the course of DWR projects. These California provisions are entirely compatible with the Federal Power Act.

DWR relies upon the Federal Power Act to invoke federal jurisdiction. But the Federal Power Act does not create or eliminate liability nor does it prescribe a forum for adjudication of liability; it merely preserves existing remedies against licensees. (16 U.S.C. Sec. 803 (c).) Indeed, with regard to matters like the present one which are concerned with assuring water for irrigation and domestic purposes, the Federal Power Act specifically states:

"Nothing contained in this chapter shall be construed as affecting or intending to affect or in any way to interfere with the laws of the respective States relating to the control, appropriation, use or distribution of water used in irrigation or for municipal or other uses, or any vested right acquired therein." (16 U.S.C. Sec. 821.)

Furthermore, DWR's action is grounded upon the theory that OWID is seeking enforement of rights and duties arising under the Federal Power Act. Upon the facts, this is clearly erroneous. The action of OWID, in its application to CPUC, is strictly based upon the Sections 11590-11592 of the California Water Code. Consequently, there is no justiciable controversy capable of judicial determination regarding the application of OWID. Any determination of the effect of an application predicated on the Federal Power Act would be upon a hypothetical state of facts. (Aetna Life Insurance Co. v. Haworth, 300 U.S. 827.)

Given the true facts about OWID's application, Title 16, U.S.C. Section 825p upon which DWR relies, is not applicable as the application does not rest upon any duty, liability, rule, regulation or order under the Federal Power Act. OWID is seeking rights under the California Water Code. The provisions of the Federal Power Act have been invoked only by DWR and only as defenses to OWID's claim. Such defenses are not a proper basis for federal court intervention and jurisdiction. (Public Serv. Comm. v. Wycoff, supra, 344 U.S. 237; Skelly Oil Co. v. Phillips Co., 339 U.S. 667.)

In support of its contention that the matter is within the purview of federal law, DWR relies primarily on First-Iowa Hydroelectric Cooperative v. Federal Power Commission, 328 U.S. 152. This case is clearly distinguishable from the present situation. In the First-Iowa case, a state statute required approval of the state prior to commencement of work on a dam and electric project. The applicant in that case sought a license from the Federal Power Commission (FPC) and the state contended that the licensee must also show compliance with the state laws regarding construction of the dam and power site, prior to obtaining a permit from the FPC. The Court held that the Federal Power Act did in that instance supersede the state law as it was clearly in direct conflict with the FPC action and provisions of the Federal Power Act. Here, there is no conflict or interference with the Federal Power Act or the FPC. Any action taken by CPUC would merely determine who has the obligation under the California Water Code with respect to the relocation of certain of OWID's facilities. However, there is nothing in OWID's application before the CPUC, nor any suggestion of any prospective action of the CPUC, that either OWID seeks, or the CPUC intends to interfere with any FPC action or Federal Power Act statute.

CPUC Has Not Made a Final Determination; DWR's Contentions Are Premature, Its Rights Protected by Adequate Judicial Remedies.

CPUC has not made a final determination of OWID's application. When such a determination is made, if DWR considers its rights to have been adversely affected, DWR will have adequate remedies at law to raise any jurisdictional arguments, namely, by petition for rehearing before CPUC and then by petition for review directly to

the California Supreme Court. (Section 1731, et seq. and 1756, et seq., Calif. Pub. Util. Code.) DWR, if still dissatisfied, may then directly seek review before the United States Supreme Court. (28 U.S.C. Sec. 1257.)

The District Court's Action Should Also Be Sustained on Grounds of Comity.

DWR seeks in the instant proceeding to restrain a constitutionally created agency of the State of California from performing its lawful function. As we have seen, CPUC has not as yet made a final determination on OWID's application. DWR has plain, adequate and speedy judicial remedies to test the validity of any CPUC decision in the California Supreme Court. On this basis, the exercise of federal jurisdiction, even if applicable, should be withheld on consideration of comity since California law provides for judicial review of any CPUC order and for its stay pending review. (Alabama Pub. Serv. Com. v. Southern R. Co., 341 U.S. 341.)

Furthermore, the fact that the action is against agencies of the State of California also raises the bar of the Eleventh Amendment. The language of that amendment prohibits federal court suits brought against a state by citizens of another state, but it has been construed to prohibit federal court suits against a state brought by citizens against the state of which they are citizens as well. (Parden v. Terminal R. of Alabama Docks Dept., 377 U.S. 184, 186; Hans v. Louisiana, 134 U.S. 1; Fitts v. McGhee, 172 U.S. 516, 524-25; North Carolina v. Temple, 134 U.S. 22, 30.) A fortiori, it prohibits suits by one state agency against a sister state agency.

CONCLUSION

For the foregoing reasons, the judgment of the District Court should be affirmed.

Dated: April 22, 1968.

Respectfully submitted,

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> Attorneys for Appellee California Public Utilities Commission

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

TIMOTHY E. TREACY

IN THE

MAS CONTY **LINITED STATES COURT OF APPEALS** FOR THE NINTH CIRCUIT

THE STATE OF CALIFORNIA, Acting by and through the DEPARTMENT OF WATER RESOURCES.

Appellant,

VS.

THE OROVILLE-WYANDOTTE IRRI-GATION DISTRICT, an irrigation district, and the CALIFORNIA PUBLIC UTILI-TIES COMMISSION, a public commission, Appellees.

APPELLANT'S REPLY BRIEF

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IN THE

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

THE STATE OF CALIFORNIA, Acting by and through the DEPARTMENT OF WATER RESOURCES,

Appellant,

VS.

THE OROVILLE-WYANDOTTE IRRI-GATION DISTRICT, an irrigation district, and the CALIFORNIA PUBLIC UTILI-TIES COMMISSION, a public commission, Appellees.

APPELLANT'S REPLY BRIEF

I

STATEMENT OF THE CASE

OWID offers this court, under the guise of a new statement of the case, additional facts concerning the approval of Project 2088 by various state agencies and prior negotiations between DWR and OWID (OWID 2-3). These facts and the conclusions to be drawn from them are subject to dispute. Further, and most significant, they are not relevant to the issue of who has jurisdiction to determine this matter, nor to the propriety of injunctive or declaratory relief.

By recitation of these additional facts OWID endeavors to argue the issue of liability, relying heavily on the theory of estoppel. Unfortunately, the merits of this issue are not before this court for review.

We submit that the facts relevant to the issues raised by this appeal are set forth in DWR's statement of the case and are undisputed.

11

ARGUMENT

A. Summary

OWID and CPUC characterize this dispute as one in the nature of condemnation, request that this court exercise comity, and assert that this action is barred by Section 27 of the Federal Power Act, the Eleventh Amendment of the United States Constitution, and the status of DWR, OWID and CPUC as agencies of the State of California. Further, OWID and CPUC assert that the FPC has no jurisdiction over the issue of liability.

This is not a dispute in the nature of condemnation. This is a dispute over the obligation of an FPC licensee, OWID, to comply with and assume the economic burden of duties, orders, and regulations imposed by the Federal Power Act and the FPC.

This is not a proper case for the exercise of comity. CPUC has no regulatory authority over OWID, and Water Code Sections 11590-11592 do not purport to accord CPUC such broad regulatory authority over

DWR as to justify the exercise of comity under the holding of Alabama Public Service Commission v. Southern Railway Company, 341 U.S. 341 (1951).

Section 27 of the Federal Power Act is not relevant to this dispute. This dispute does not involve any interference with a water right or raise any issue over the allocation of waters of the South Fork of the Feather River as between Projects 2100 and 2088.

This type of action is not barred by the Eleventh Amendment. Alabama Public Service Commission v. Southern Railway Company (supra). Neither is it barred because the parties thereto are state agencies. Section 317 of the Federal Power Act does not exempt from its provisions, either expressly or implicitly, disputes between FPC licensees that are public agencies of the same state.

Whether or not the FPC has authority to determine the issue of liability is not relevant to this dispute. Any authority that does exist is, clearly, held either by the FPC, or the District Court under Section 317 of the Federal Power Act, or both. DWR does not ask this court to determine as between the FPC and the District Court which has partial or complete jurisdiction over the issue of liability. DWR asks only that this court declare that CPUC has no jurisdiction over this issue, or any other issue raised by this dispute. DWR requests this court to direct the District Court to stay proceedings on the issue of liability until the authority of the FPC on this issue has been determined by judicial review.

B. This Dispute Is Erroneously Characterized By Appellees
As One In The Nature Of Condemnation; It Is Not; It Is
A Dispute Over The Obligation Of OWID As An FPC
Licensee To Comply With Duties, Orders, And Regulations Imposed By The Federal Power Act And FPC,
And The Authority Of CPUC To Vary Such

OWID endeavors to characterize this dispute as one in the nature of condemnation. It states (OWID 19):

"Clearly, one whose reservoir impairs or destroys another's property would, under general principles of law, be liable to that person. Section 10(e) simply confirms that this liability survives issuance of the license. See Ford and Son v. Little Falls Fibre Co., 280 U.S. 369 (1930).

"That is what OWID is concerned with in the CPUC proceedings."

Based on this characterization OWID urges that CPUC has jurisdiction of this dispute, citing as authority condemnation cases involving issues of compensation (OWID 20) and local policy (OWID 33).

Based on this characterization CPUC blandly asserts (CPUC 5):

". . . DWR's action is grounded upon the theory that OWID is seeking enforcement of rights and duties arising under the Federal Power Act. Upon the facts, this is clearly erroneous. The action of OWID, in its application to CPUC, is strictly based upon the Sections 11590–11592 of the California Water Code."

If this is a condemnation dispute it is clear that local statutes, such as Water Code Sections 11590-11592 cannot qualify an FPC licensee's right to bring an ordinary condemnation action in a federal district court pursuant to Section 21 of the Federal Power Act, 16 U.S.C. 814. Beezer v. City of Seattle, 62 Wash. 2d 569, 383 P.2d 895 (1963); reversed, City of Seattle v. Beezer, 376 U.S. 224 (1964). However, this is not a condemnation dispute. First, it is a dispute over the obligation of an FPC licensee, OWID, to comply with duties, orders, and regulations imposed by the Federal Power Act and the FPC. Second, it is a dispute over the jurisdiction and authority of a state agency, CPUC, to shift the economic burden of these duties, orders, and regulations to another FPC licensee, DWR. Third, it is a dispute over the jurisdiction and authority of CPUC to determine what modifications, if any, are required to make one FPC licensed project compatible with another.

With respect to the first and second points, above, this dispute is analogous to that involved in Big Horn Power Co. v. State, 23 Wyo. 271, 148 Pac. 1110 (1915) and the related case of Clarke, et al v. Boysen, et al, 39 F.2d 800 (C.A. 10th 1930). In the Big Horn case the defendant (Big Horn) had been granted a license by the state engineer to construct a dam to a specified height. The dam was constructed higher than licensed and as a result interfered with the plans of the Burlington Railroad to construct a railway in the gorge

behind the dam, the very conflict which the height limitation in Big Horn's license was intended to avoid.

The state successfully prosecuted an action to compel Big Horn to modify the dam. The dam was not modified and in *Clarke*, et al v. Boysen, et al the Burlington Railroad sought to quiet Burlington's title to the right-of-way for the railway and to compel Clarke and others, owners of interests in the dam constructed by the Big Horn Power Company, to modify the dam.¹

Burlington prevailed in the lower court. On appeal, counsel for Clarke sought to characterize the decision of the lower court as authorizing condemnation of land devoted to a public use. The court stated (pp. 815–816):

"The theory of counsel for Clarke is that the land was already devoted to public use and that the Burlington Company could not condemn such land under its power of eminent domain.

"The right-of-way does not impair the use of the lawful portion of the dam structure and the protection of the Burlington Company's rights and interests therein will in no wise impair or interfere with the use of such lawful portion. The fact that the protection of the rights and interests of the Burlington Company in such right-of-way will interfere with the maintenance of the unlawful portion of the dam structure, in our opinion, is not material." (Emphasis added.)

¹ The decision in the *Clarke* case dealt with several appeals dealing with various issues. Our comments are limited to that portion of the decision dealing with cause No. 1513 which is discussed on pages 813-821 of 39 F.2d.

Counsel for Clarke also sought to invalidate the lower court's decision on the theory of estoppel. The court stated (p. 818):

"Counsel for the Clarke group further contend that the Burlington Company is estopped to complain of such superstructure and narrow spillway as a nuisance, because the dam and superstructure were constructed and completed before the construction of the railway.

"The Burlington Company's predecessor, the Big Horn Railroad Company, filed its application for its right-of-way in March, 1905. When application was made to the state engineer for the approval of a dam 60 feet in height, the Burlington Company protested and the state engineer limited the height of the dam to 35 feet and approved the plans for a dam 35 feet in height with a spillway 125 feet long. Under these facts, the Burlington Company clearly had the right to construct its railroad on its right-of-way and to rely upon its right to require the dam to be modified to conform to a lawful structure." (Emphasis added.)

The Big Horn and Clarke cases illustrate that the regulation of OWID by the FPC, and the responsibilities of OWID under the Federal Power Act, do not create a condemnation dispute merely because such regulations and responsibilities might enure to the benefit of DWR. In the court's own words (39 F.2d at page 816):

The Wycoff case is of course only one of a number of cases in which the federal courts have rejected efforts such as DWR's effort to "rush into federal court to get a declaration which... is intended... to tie the Commission's hands before it can act..." (344 U.S. at p. 247) Even before Wycoff, the Supreme Court refused to countenance such attempts to circumvent state administrative proceedings. In Petroleum Exploration, Inc. v. Public Service Commission, 304 U.S. 209 (1938), a gas company sought a federal court injunction against proceedings before the Kentucky Public Service Commission to fix the company's rates on the grounds that the proceedings were beyond the Commission's jurisdiction and in violation of the company's constitutional rights. The Court refused to intervene, declaring at pp. 222-23:

"By the process of injunction the federal courts are asked to stop at the threshold, the effort of the Public Service Commission of Kentucky to investigate matters entrusted to its care by a statute of that Commonwealth obviously within the bounds of state authority in many of its provisions. The preservation of the autonomy of the states is fundamental in our constitutional system. The extraordinary powers of injunction should be employed to interfere with the action of the state or the depositaries of its delegated powers, only when it clearly appears that the weight of convenience is upon the side of the protestant. 'Only a case of manifest oppression will justify a federal court in laving such a check upon administrative officers acting colore officii in a conscientious endeavor to fulfill their duty to the state."

And the Court has reaffirmed its disapproval of such "end-run" tactics as DWR here seeks to employ subsequent

to Wycoff. In Public Utilities Commission v. United Air Lines, 346 U.S. 402 (1953), an airline sought federal declaratory relief from regulation by CPUC on the grounds that such regulation was outside the jurisdiction of the Commission and was unconstitutional. The Court, in a per curiam decision, summarily reversed a three-judge federal tribunal which had granted the relief, citing its opinion in Wycoff. See, also, Topp-Cola Company v. Coca-Cola Company, 314 F.2d 124 (2d Cir. 1963), holding at page 126 that an applicant for advantages conferred by local trademark registration laws "may not use a declaratory judgment action in order to remove to a federal court an opposition proceeding before local [administrative] authorities" and Gill v. Iowa-Illinois Gas and Electric Company, 233 F.2d 145 (7th Cir. 1956), affirming dismissal of an action by consumers of electricity, supplied by a public utility, for an injunction against regulation of the utility's rates by the Illinois Commerce Commission and for a declaration that such regulation was exclusively within the jurisdiction of the FPC.

DWR's concurrent request for a declaration of exclusive jurisdiction in the FPC under the Federal Power Act (CT 62) is simply another effort to block the CPUC proceedings and without merit for the reasons already discussed. Gill v. Iowa Gas and Electric Company, above, is squarely in point and establishes that such a declaration would be improper. In that case the plaintiffs asked for a declaration of exclusive FPC jurisdiction, or, in the court's words, "urge[d] the judiciary to correct alleged administrative under-enforcement at the national level, i.e., Federal Power Commission." (233 F.2d 146) The Court denounced this attempted use of the declaratory judgment procedure "as an ignition switch by which to start the machinery of the federal administrative agency", stating at pp. 146-147:

"Utilizing a remedy labeled 'declaratory judgment' adds nothing significant to plaintiffs' abortive effort to short circuit procedural and administrative steps intimately connected with the regulation and supervision of the public utility, Iowa-Illinois . . . We think the district judge correctly declined to indirectly coerce or activate the Federal Power Commission or oust the Illinois Commerce Commission."

In Part II of this brief we show that DWR's arguments respecting FPC jurisdiction are mistaken on the merits. But even if one were to accept, for purposes of discussion, DWR's argument that OWID's alleged violations of Section 10 give FPC jurisdiction to the exclusion of CPUC, it is clear that if the FPC fails to find violations (as we think it must), DWR's entire argument collapses. The Court therefore is being asked to prejudge an issue now properly before administrative agencies and to interfere with state administrative proceedings on the strength of a speculative assumption which may shortly be proved wrong. Such action would be a mistake and is moreover unnecessary for the protection of DWR's rights.

2. Declaration Concerning DWR's Right to Bring Future Lawsuits (1.d; 1.e).

As for the requested declaration that DWR has a right to maintain eminent domain proceedings under Section 21 of the Federal Power Act (CT 63) or ejectment proceedings (CT 64), the complete answer was given by this Court in *United States v. Central Stockholders' Corp. of Vallejo*, 52 F.2d 322 (9th Cir. 1931). There the United States had brought suit to determine that the defendant had no right to prevent the United States and its Federal Power Act licensee from constructing certain reservoirs, and no right to be compensated for loss of water occasioned by the impounding of water by the United States and its licensee.

The Court held that those were nonjusticiable abstract questions, and that if the United States wanted to impound the water, its remedy was to do it. See also, *United States* v. West Virginia, 295 U.S. 463 (1935)*

Declaration Concerning the Effects of Violation of the Federal Power Act (1.a; 1.c).

At virtually every point in its brief DWR refers to the Federal Power Act, particularly Sections 10(a), 10(b) and 10(c), and argues the asserted effects on its obligations to OWID. Its position seems to be that it has no obligations to OWID because OWID violated these provisions (O.B. 26-27) by misrepresenting the effects of the Reservoir and failing to construct the South Fork Project in a manner approved by FPC. (O.B. pp. 22-24, 35-36) Even if DWR's claim of violation were true (which it is not), no authority is cited for the proposition that DWR can therefore destroy OWID's facilities with impunity, and we know of no such authority.

For reasons which are not disclosed anywhere in its brief, DWR has attached to its brief the initial decision of an FPC examiner. Not being a part of the record, the initial decision manifestly is not properly before the Court. Moreover, it certainly does not demonstrate FPC support for DWR's legal or factual substantive position. It is nothing more than a recommendation to the FPC, which alone can make a decision; exceptions will be filed to this recommendation which will demonstrate its error in many important respects. What the initial decision does show vividly is that DWR asked the court below, and now asks this Court, to pre-empt and prejudge complex factual issues presently before administrative tribunals. In short, it underscores the

^{*}Central Stockholders was decided before the Declaratory Judgment Act, West Virginia after adoption of the Act.

impropriety of federal court intervention at this juncture, as does DWR's own request here for a *stay* of further proceedings until a final FPC decision has been rendered. (O.B. p. 53)

DWR's substantive contentions, even if valid, are in any event, in the nature of *defenses* to OWID's claim before the CPUC, as is clearly shown by DWR's brief. (O.B. pp. 20, 25, 28, 33 and 36) The existence of defenses arising under federal law does not, however, create an affirmative cause of action for relief:

"Respondent here has sought to ward off possible action of the petitioners by seeking a declaratory judgment to the effect that he will have a good defense when and if that cause of action is asserted. Where the complaint in an action for declaratory judgment seeks in essence to assert a defense to an impending or threatened state court action, it is the character of the threatened action, and not of the defense, which will determine whether there is federal-question jurisdiction in the District Court. If the cause of action, which the declaratory defendant threatens to assert, does not itself involve a claim under federal law, it is doubtful if a federal court may entertain an action for a declaratory judgment establishing a defense to that claim. This is dubious even though the declaratory complaint sets forth a claim of federal right, if that right is in reality in the nature of a defense to a threatened cause of action. Federal courts will not seize litigations from state courts merely because one, normally a defendant, goes to federal court to begin his federal-law defense before the state court begins the case under state law." Public Service Commission of Utah v. Wycoff Co., 344 U.S. 237, 248 (1952), emphasis added; see, also, Skelly Oil Co. v. Phillips Co., 339 U.S. 667, 671-674 (1950); Bonanza Airlines, Inc. v. Public Service Commission, 186 F.Supp. 674, 679 (D.Nev. 1960); Arrow Lakes Dairy, Inc. v. Gill, 200 F.Supp. 729, 731-732 (D. Conn. 1961).

4. Declaration Concerning the Future Effects of DWR's Reservoir (1.d).

Finally, DWR's request for a declaration that it "will not take or damage any lands or property belonging to [OWID]" (CT 63) is so far beyond the pale as to require no comment.

The federal courts will not—and constitutionally cannot -issue declarations which are abstract or hypothetical, and hence premature. The power to grant declaratory relief is limited to a "concrete case admitting of an immediate and definitive determination of the legal rights of the parties." Public Service Commission of Utah v. Wycoff Co., above, at p. 243. This is not such a case. As has been shown above, the court could not make a blanket declaration of nonliaoility without regard to what the circumstances may be in which DWR takes or damages OWID's property. It cannot nake an abstract declaration of DWR's right to maintain and prevail in other lawsuits, without regard to what facts might be proved in such suits. It certainly cannot declare that DWR's project will not cause injury to OWID's property. The declaratory judgment act gives the court no power to issue predictions of future facts. See 28 U.S.C. § 2201; United States v. West Virginia, above; Fair v. Dekle, 367 F.2d 377 (5th Cir. 1966), cert. denied, 386 U.S. 996 (1967)

- Sections 11590-11592 of the Water Code Are Valid and Vest CPUC With Jurisdiction Over Certain Phases of the Dispute Between the Parties
- A. DWR'S ARGUMENTS ON THE MERITS OF ITS "FEDERAL LAW CLAIMS"
 ARE IRRELEVANT AND PREMATURE

The only issue which is properly before this Court is whether the judgment below can be sustained on any ground. See, *Jaffke v. Dunham*, 352 U.S. 280, 281 (1957). We have shown above why it should be sustained on the ground on

which the judgment was rendered. But even if this Court were to reach the merits of DWR's attack on W.C. Sections 11590-11592 and CPUC jurisdiction, the judgment has to be sustained unless, regardless of the facts and *under any construction or application*, Sections 11590-11592 must be struck down and the CPUC held to be without jurisdiction.

As a general proposition, federal courts will not go out of their way to strike down state statutes as invalid. Such action is, and should be, a last resort only. If a statute can be interpreted in a way which will render it valid, it should be given such an interpretation.

"If an interpretation of a state statute can be reasonably adopted which does not bring the enactment within the inhibition of federal law, that interpretation should prevail against another which would rest upon an assumption that the state legislature intended to enact a law in conflict with the constitution or statutes of the United States." Rushton v. Schram, 143 F.2d 554, 559 (6th Cir. 1944); accord, Associated Press v. National Labor Relations Board, 301 U.S. 103, 132 (1937).

This principle ought to be of particular force where the attack on the statute is made before the factual record has been developed before the administrative agency and the agency has had an opportunity to interpret the statute. (In this connection, see the discussion respecting prematurity, Part I, above). Moreover, DWR's standing to attack the validity of the very statute from which it derives its existence is subject to substantial doubt. See, Heim v. McCall, 239 U.S. 175, 190 (1915).

B. DWR'S ARGUMENTS ON THE MERITS ARE ERRONEOUS

In any event, examination of the Federal Power Act and the California Water Code discloses that the former does not intrude into the area of the latter and that there is no conflict between them, at least so far as this case is concerned. While Sections 10(a), 10(b) and 10(c) of the Act give the FPC power to require modifications before approval of a project, to approve modifications subsequently and to require a licensee to maintain its project, Section 10(c) also provides that

"Each licensee hereunder shall be liable for all damages occasioned to the property of others by the construction, maintenance, or operation of the project works..."*

When FPC issued its license to DWR for the Oroville project, in 1956 and again in 1957, it specifically noted the possibility of damage being caused to OWID's Miners Ranch Canal and gave DWR notice that "the provisions of Section 10(c) of the act make each licensee liable for all damages occasioned to the property of others . . ." (16 FPC at pp. 1340-1341).

The effect of Section 10 (c), and of the proviso in DWR's license, is to preserve such liability as exists under general law and to preclude creation of immunity in a licensee.

Clearly, one whose reservoir impairs or destroys another's property would, under general principles of law, be liable to that person. Section 10(c) simply confirms that this liability survives issuance of the license. See, Ford & Son v. Little Falls Fibre Co., 280 U.S. 369 (1930).

That is what OWID is concerned with in the CPUC proceedings. It is an irrigation district responsible for supplying essential domestic and irrigation water to some 15,000 people and 5,000 acres in Butte County. Its South Fork Project is a part of the California Water Plan, carried out under DWR's aegis. (DWR Bulletin 3, May 1957, p. 108,

^{*}DWR's brief studiously omits any reference to this provision.

plate 5 sheet 6, CT 159) After many years of cooperative and coordinated effort with DWR in the development of the Feather River water resources, it was suddenly faced with a repudiation by DWR of responsibility for the consequences of Oroville Reservoir in May 1966. (CT 75) To protect the interests of the local water users which it serves, the application was then filed with the CPUC to resolve this question of responsibility.

The Federal Power Act does not deal with this kind of problem. It does not provide a remedy. It does not confer jurisdiction on FPC to determine questions of liability for damage done by a licensee, and it does not preclude state tribunals such as CPUC from hearing and determining such questions. The FPC itself has always held that tribunals other than itself possessed jurisdiction to adjudicate liability issues. Alabama Power Co., 58 P.U.R. 3rd 407, 410 (1965); Idaho Power Co., 29 F.P.C. 29 (1963); Department of Water Resources, 28 F.P.C. 3, 4 (1962). Since the Ford case, above, it has not been questioned that state tribunals have at least concurrent jurisdiction.

State jurisdiction of compensation questions, and the application of state rules to such questions, is certainly not abhorrent to the Act. An unbroken line of authority holds that state laws fixing the amount of money an FPC licensee must pay to those with whose property it interferes are valid and binding upon the licensee. See, Feltz v. Central Nebraska Public Power & Irrigation District, 124 F.2d 578 (8th Cir. 1942) (state law determines the amount of consequential damages licensee must pay upon taking property); United States v. Central Stockholders' Corp. of Vallejo, 52 F.2d 322 (9th Cir. 1931) (licensee must pay riparians damage caused by its diverting water because state law so provides); Ford & Son v. Little Falls Fibre Co., 280 U.S.

369 (1930) (same); Central Nebraska Public Power & Irrigation District v. Fairchild, 126 F.2d 302 (8th Cir. 1942) (state law determines the amount of interest payable by licensee upon taking property, even though it imposes greater burdens on licensee than general law respecting interest).*

Indeed, Section 21 of the Act specifically contemplates that the amount payable by a licensee for property taken or destroyed may be fixed in the first instance by contract—which would be governed by state law. It further provides that even in the event of a taking by eminent domain, a condemnation action may be brought in the state court and, even if it is not brought there, the practice and procedure shall conform as nearly as possible with that in the state courts. 16 U.S.C. § 814. With respect to the liability of a licensee to provide substitute or relocated facilities for those which it takes or destroys, the Act leaves that subject untouched. See, Feltz v. Central Nebraska Public Power & Irrigation District, above, at p. 582.

There is, therefore no reason to assume that Congress meant to preclude anyone injured by a licensee's activities from recovering damages by action in a state tribunal. There is also no reason to suppose that Congress meant to single out damaged licensees and deprive them alone of the right enjoyed by others to recover for the damages done to them by other licensees. And there is certainly no reason to assume that Congress meant to oust state utilities commissions from jurisdiction, particularly where the question of liability transcends a private dispute and is between two state agencies responsible for the protection of the important public interest in an uninterrupted water supply.

^{*}See also Broad River Power Co. v. Query, 288 U.S. 178 (1933), which provides that a state may tax the production of power by an FPC licensee.

That conclusion is not changed by the fact that W.C. Sections 11590-11592 contemplate the provision of substitute facilities—this being the measure of damages under general law in the type of cases covered by Section 11590. See, e.g., State of Washington v. United States, 214 F.2d 33, 39 (9th Cir. 1954), cert. den. 348 U.S. 862 (1954).

DWR argues, however, that provision of substitute facilities may involve modification of licensed project works. If it does, it is of course subject to prior approval of FPC. This is the position consistently taken by OWID (CT 167-168) and accepted by CPUC. (CT 282) It was also the thrust of this Court's order of September 11, 1967, denying DWR's motion for a restraining order as unnecessary. But Section 10(b) only provides that FPC approval must be obtained before substantial modifications are made. It does not give FPC, as DWR argues, exclusive jurisdiction to "require" modifications now (O.B. p. 36), much less to adjudicate liability.* It certainly does not prohibit another tribunal from awarding damages which may involve the making of modifications, so long as FPC approval is obtained before they are made. And it certainly does not clothe DWR in immunity for damage it may do (as it contends here) or prohibit other tribunals from allocating liability for the adverse consequences of a licensee's activities. particularly where the allocation is between two state agencies. In other words, even assuming that the Act imposes some limitations on CPUC jurisdiction, it cannot be said that CPUC is totally lacking in any jurisdiction what-

^{*}In fact, the FPC's jurisdiction is circumscribed by the Act which prohibits it from altering outstanding licenses without the licensee's consent (Sec. 6) and authorizes it to require modification of project works only before the project has been approved. (Sec. 10(a))

ever touching the problem and accordingly the requested relief, which would oust it completely, was properly denied.

DWR's only authority is First Iowa Hydro-Electric Cooperative v. FPC, 328 U.S. 152 (1946), said to establish FPC's "comprehensive and exclusive jurisdiction . . . over the planning, financing and construction of projects . . ." (O.B. p. 33) But that case only held that Section 9 (b) of the Act, requiring an applicant to submit with its application to the FPC satisfactory evidence of compliance with state law, did not require FPC to refuse issuance of a license until the applicant had obtained a state permit for the project as required by state law in that case. That the Court was concerned solely with the validity of state laws which give state officials a veto power over federally licensed projects is abundantly clear from the opinion:

"To require the petitioner to secure the actual grant to it of a state permit under § 7767 as a condition precedent to securing a federal license for the same project under the Federal Power Act would vest in the Executive Council of Iowa a veto power over the federal project. Such a veto power easily could destroy the effectiveness of the Federal Act. It would subordinate to the control of the State the 'comprehensive' planning which the Act provides shall depend upon the judgment of the Federal Power Commission or other representatives of the Federal Government. * * * In the Federal Power Act there is a separation of those subjects which remain under the jurisdiction of the States from those subjects which the Constitution delegates to the United States and over which Congress vests the Federal Power Commission with authority to act. To the extent of this separation, the Act establishes a dual system of control. The duality of control consists merely of the division of the common enterprise between two cooperating agencies of government, each with final authority in its own jurisdiction. The duality does not require two agencies to share in the final decision of the same issue. Where the Federal Government supersedes the state government there is no suggestion that the two agencies both shall have final authority. * * * A dual final authority, with a duplicate system of state permits and federal licenses required for each project, would be unworkable." (328 U.S. 152 at pp. 164, 167-168, emphasis added.)

Sections 11590-11592 do not, of course, give state officials a veto power over DWR's project and are not intended to do so. They do not interfere with the carrying out of a federally licensed project, and no relief threatening such interference is sought under them. The CPUC has construed them as not conflicting with the Federal Act. See, Feather River Railway Co., 61 P.U.C. 728 (1963), writ of review denied, August 12, 1964; County of Butte, 62 P.U.C. 537 (1964), writ of review denied, March 1965. DWR asks this Court, contrary to precedent and common sense, to assume that conflicting orders are likely to be issued, although such orders are neither sought nor necessary. Rushton v. Schram, 143 F.2d 554 (6th Cir. 1944); Erlich v. Municipal Court, 360 P.2d 334, 55 C.2d 553, 558 (1961); Hughes v. City of Lincoln, 43 Cal. Rptr. 306, 232 C.A.2d 741, 749 (1965).

The First Iowa case recognizes the existence of a dual system of control under the Act, leaving certain subjects to control by the states. (See pp. 20-21, above) One of those subjects in which state law has traditionally controlled, as pointed out above, is the determination of liability for damage done by a licensee to the property of others. DWR's brief will be read in vain for any demonstration why it follows that the existence of FPC jurisdiction under Sections 10(a), 10(b) or 10(c) compels the conclusion that no

valid CPUC order can be made in this case.* Quite the contrary, a reading of these statutes and the cases demonstrates that this is one of those common situations where federal and state jurisdiction can and should be accommodated. Certainly the Court should be slow to impute to Congress an intention to prevent the exercise of state power in a matter of serious public concern where no authority is given to the federal agency to meet the need, i.e., allocating the burden of damage caused by DWR's project. Atchison, T. & S. F. Ry. Co. v. Railroad Commission, 283 U.S. 380, 391 (1931) (where the state commission ordered relocation of rail lines subject to the necessary approval of the Interstate Commerce Commission, showing that, DWR's argument notwithstanding, conflict between state and federal orders is not inevitable).

III. DWR Is Not Entitled to Injunctive Relief.

All that has been said to this point applies equally to refute DWR's claim to injunctive relief; that claim is made prematurely (Part I) and is substantively without merit (Part II). The claim appears to be based on the contention that there is a

"potential source of conflict that could result from independent decisions of the FPC and CPUC." (O.B. p. 44)†

It is self-evident that this is not a sufficient ground to enjoin the operation of a state statute and the proceedings

^{*}The most DWR seems to say is that there is a "potential source of conflict that could result from independent decisions of the FPC and CPUC". (O.B. p. 44) This argument demonstrates that the action is premature and it is certainly insufficient to strike down a state statute. (See Parts I and III) Moreover, as pointed out above, DWR's argument assumes that OWID modified its Canal and constructed it without FPC approval (O.B. pp. 36, 38), and these facts are disputed and for the administrative agencies to determine.

[†]Compare the ground urged by DWR in support of its requests for an injunction below, namely, that the federal act supersedes and preempts Sections 11590-11592. (CT 354, 495)

of a state agency, even if the arguments of Parts I and II, above, were ignored.

To begin with, the claim is wholly lacking in equity because DWR has not shown "any threatened or probable act of the [appellees] which might cause the irreparable injury essential to equitable relief by injunction." Public Service Commission of Utah v. Wycoff Co., above at p. 241.

Neither OWID nor CPUC has threatened, or contemplates, any action whatever that might in any way interfere with DWR's project. OWID is merely pursuing its remedy to secure relief for the damage with which its project is threatened by DWR. It does not oppose any taking or other action connected with DWR's project. The CPUC has taken the same position in this proceeding. (CT 112) Hence there is not even an issue or controversy, let alone threatened injury, respecting DWR's right to carry out its project and to take whatever property or action it needs for the purpose. There is, therefore, no threat of irreparable injury to DWR, much less an imminent one, and no right to an injunction.*

United States v. West Virginia, 295 U.S. 463 (1935) so holds. In that case, the United States brought suit to enjoin a state from asserting that its right to license a particular power project was superior to the United States' right to do so, and for a declaration that the United States' right was in fact superior. There was "no allegation of any interference by the State, actual or threatened, with any of the land or property" the United States had acquired

^{*}It has long been settled that the expense and inconvenience of litigation are not the kinds of irreparable harm against which equity proteets. Myers v. Bethlehem Shipbuilding Corp., 303 U.S. 41, 51-52 (1938). See, also, Macauley v. Waterman Steamship Corp., 327 U.S. 540, 544-545 (1946), to the effect that questions of statutory coverage are not to be decided by injunction suits when the administrative process "had hardly begun."

for the project. (p. 471) The Supreme Court denied relief, and, further, held that those facts did not state a justiciable case or controversy. See also New York v. Illinois and Sanitary District of Chicago, 274 U.S. 488 (1927) (no right to enjoin diversion of water absent a showing that existing project will be affected by it).

Moreover, DWR's remedies in pending proceedings before PUC and FPC are adequate. DWR has asserted its defenses there and, if necessary, can appeal any adverse final orders.

"The procedures of review usually afford ample protection to a carrier whose federal rights are actually invaded, and there are remedies for threatened irreparable injuries. State courts are bound equally with the federal courts by the Federal Constitution and laws. Ultimate recourse may be had to this Court by certiorari if a state court has allegedly denied a federal right." Public Service Commission of Utah v. Wycoff Co., supra, pp. 247-248.

DWR's appeal for injunctive relief, based on the opposite premise (O.B. p. 41-42), is therefore groundless. See also, Great Lakes Dredge & Dock Co. v. Huffman, 319 U.S. 293 (1943); Toomer v. Witsell, 334 U.S. 385 (1948).

The cases DWR cites to support its claim for injunction do not help it in the slightest and demonstrate the lack of equity of its case. (O.B. pp. 45-47)

In Chicago v. Atchison, T. & S. F. Ry. Co., 357 U.S. 77 (1958), the interstate railroads had engaged a motor carrier to transfer their interstate passengers and baggage between railroad stations in Chicago. The City then adopted an ordinance prohibiting the carrier from operating unless it first obtained a city certificate and approval of the City Council. When the carrier refused to do so, the City threatened to arrest and fine its drivers for operating

without a certificate. The Court held that the movement of passengers and baggage between these stations was interstate commerce, that the city ordinance was invalid insofar as it prohibited such transfers without a city certificate and that the carrier was entitled to relief against the city's enforcement efforts by threats of arrests and fines.

Cloverleaf Co. v. Patterson, 315 U.S. 148 (1942), held that an injunction would lie against state officials who on sixteen occasions entered plaintiff's plant and under state pure food laws seized twenty thousand pounds of packing stock butter from which plaintiff manufactured renovated butter, jeopardizing plaintiff's ability to continue in business. Plaintiff held the stock for manufacture into renovated butter to be shipped in interstate commerce. The Court held that since federal legislation covered the production of this product for shipment in interstate commerce, state officials could not confiscate a product which met Federal requirements and thereby interfere with, indeed prohibit, interstate commerce.

In Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947), proceedings were brought before the Illinois Commerce Commission to regulate warehousemen under the state regulatory law. The Court found that certain phases of that regulation, including rate regulation and licensing requirements, were covered by the federal act and that Congress in these respects had unequivocally provided federal regulation to be exclusive. It specifically distinguished instances of dual control by state and federal authorities, citing the First Iowa case, above. Other phases of the state regulatory scheme were not covered by the federal act. As to these the court said:

"Any such objections are at this stage premature. Congress has not foreclosed state action by adopting a policy of its own on these matters. Into these fields it has not moved. By nothing that it has done has it preempted those areas. And see Federal Compress Co. v. McLean, supra, p. 23. In more ambiguous situations than this we have refused to hold that state regulation was superseded by a federal law." (331 U.S. 218 at p. 237)

These cases hold that only when there is a direct, explicit and immediate conflict in the exercise of state and federal power, resulting in immediate interference with federally protected activities or violation of the congressional mandate, will the federal court enjoin state action. Nothing of the sort exists in this case. All CPUC is undertaking is to allocate responsibility for damage as between state agencies, subject to whatever federal approvals may be required subsequently (essentially a matter of determining which pocket of the state is to pay for consequences of a reservoir). There is no threat of interference with federally authorized activities or even of curtailing any of DWR's rights or remedies.

In the court below DWR relied also on the companion case to Rice, above, Rice v. Board of Trade of the City of Chicago, 331 U.S. 247 (1947). This time it fails to cite it although it is most instructive in determining the reach of the foregoing cases. In that case, the Court upheld a denial of injunctive relief against enforcement by the Illinois Commerce Commission of state laws applicable to the Board of Trade. After noting that the federal Commodity Exchange Act contains no declaration ousting state jurisdiction, it held (unanimously):

"Respondents' claim of supersedure is, therefore, premature. Until it is known what rules the Illinois Commission will approve or adopt, it cannot be known whether there will be any conflict with the federal law. Any claim of supersedure can be preserved in the state proceedings. And the question of supersedure can be determined in light of the impact of a specific order of the state agency on the Federal Act or the regulations of the Secretary thereunder. Only if that procedure is followed can there be preserved intact the whole state domain which in actuality functions harmoniously with the federal system. For even action which seems pregnant with possibilities of conflict may, as consummated, be wholly barren of it." (331 U.S. 247 at pp. 255-256; emphasis added)

That statement controls here. Moreover, the granting of injunctive relief lies in the discretion of the trial court and in these circumstances it cannot be said that this discretion was not properly exercised. See, Yakus v. United States, 321 U.S. 414, 440 (1944); United States v. W. T. Grant Co., 345 U.S. 629, 634-636 (1953); Rice & Adams Corp. v. Lathrop, 278 U.S. 509, 514 (1929). And contrary to DWR's assertion (O.B. p. 49) and unlike Stein v. Oshinsky, 348 F.2d 999 (2nd Cir. 1965), cert. denied 382 U.S. 957 (1965) on which DWR relies, DWR's claim for injunctive relief does rest on disputed facts (see pp. 15, 25, above) which OWID has had no opportunity to meet, and it cannot therefore be adjudicted here as DWR requests. (O.B. pp. 49, 53)

IV. Comity Requires That the Judgment Below Be Sustained.

There are additional considerations supporting the judgment below. It is settled law that in the absence of compelling circumstances, the federal courts will not interfere with pending state administrative proceedings.* Alabama Public Service Commission v. Southern Ry. Co., 341 U.S. 341 (1951):

^{*}Comity is to be distinguished from abstention referred to by DWR in its brief here and below, which rests on different principles.

"As adequate state court review of an administrative order based upon predominantly local factors is available to appellee, intervention of a federal court is not necessary for the protection of federal rights. Equitable relief may be granted only when the District Court, in its sound discretion exercised with the 'scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts,' is convinced that the asserted federal right cannot be preserved except by granting the 'extraordinary relief of an injunction in the federal courts.' Considering that '[f]ew public interests have a higher claim upon the discretion of a federal chancellor than the avoidance of needless friction with state policies,' the usual rule of comity must govern the exercise of equitable jurisdiction by the District Court in this case. Whatever rights appellee may have are to be pursued through the state courts." (Pp. 349-350, citations omitted, emphasis added)

Alabama Public Service Commission was followed in Martin v. Creasy, 360 U.S. 219 (1959); Florida R.R. and Public Utilities Commission v. Atlantic Coast Line R.R. Co., 342 U.S. 844 (1951) (Memorandum decision), and Atlantic Coast Line R.R. Co. v. City of St. Petersburg, 42 F.2d 613 (5th Cir. 1957). See also Great Lakes Dredge & Dock Co. v. Huffman, 319 U.S. 293, 298 (1943).

If noninterference is the prevailing principle in the usual ase, this is the *a fortiori* case for its application for, notwithstanding the presence of federal issues, the meat of it learly involves local questions: how best to ensure a coninuing water supply to local users, and which of two State gencies ought to pay to provide or relocate the needed acilities. (See pp. 1-3, 19-20, above)

The question of how to supply the local water users is in act classically a local one. Trenton v. New Jersey, 262 U.S.

182, 185 (1923) (state has power and duty to control and conserve its water resources for the benefit of all its inhabitants). Section 28 of the Act reaffirms the local nature of this matter by declaring that "Nothing contained in this chapter [§§ 791a-793, 795-797, 798-818, and 820-825r of this title] shall be construed as affecting or intending to affect or in any way to interfere with the laws of the respective States relating to the control, appropriation, use, or distribution of water used in irrigation or for municipal or other uses, or any vested right acquired therein."*

For that reason alone this Court should not interfere or direct the lower court to interfere with the local agency's attempt to resolve it. In Alabama Public Service Commission v. Southern Ry. Co., above, for example, the Supreme Court held that a federal court should not take jurisdiction to enjoin a State Public Utilities Commission from enforcing an order prohibiting the abandonment of intrastate tracks, emphasizing that this involved the "essentially local problem" of balancing the cost to the railroad against the public need in local towns. Similarly, in Burford v. Sun Oil Co., 319 U.S. 315 (1943), the Supreme Court held that a

^{*}In addition, special circumstances exist in this case which make it particularly appropriate for the court to let the CPUC determine the application. OWID is the successor of two public utility water companies (South Federal Land and Water Company and Palermo Land and Water Company). When it acquired the systems of these companies, the CPUC issued orders requiring it to continue to serve water users in their former service areas, and these orders were upheld by the California Supreme Court. Henderson v. Oroville-Wyandotte Irrigation District, 277 Pac. 487, 207 Cal. 215 (1929); Henderson v. Oroville-Wyandotte Irrigation District, 2 P.2d 803, 213 Cal. 514 (1931); Rutherford v. Oroville-Wyandotte Irrigation District, 8 P.2d 836, 215 Cal. 124 (1932), cert. denied 287 U.S. 609 (1932). DWR's overall plan for development of the area's water resources contemplated that a substantial portion of the area would be served by OWID through Miners Ranch Canal. (CT 159) Impairment or destruction of the Canal would make it impossible for OWID to comply with the service requirements of CPUC's orders. Thus it is most appropriate for CPUC to continue to concern itself with this matter.

ederal court should not take jurisdiction to enjoin enforcement of a Commission's order granting a right to drill oil wells in Texas, because the oil industry was of great mportance to the local economy. See also, Hawks v. Hamill, 188 U.S. 52 (1933).

The issue between DWR and OWID is even more narowly local than that respecting distribution of water, infastate transportation, or Texas oil wells. The issue is imply which of these two state agencies should bear reponsibility for damage to OWID's facilities caused by OWR. State agencies are merely creatures of the state, nd the state can take money from them, or tax them, without any inhibition by federal law. See Trenton v. Vew Jersey, above; Pawhuska v. Pawhuska Oil & Gas Co., 250 U.S. 394 (1919); Hunter v. Pittsburgh, 207 U.S. 61 (1907); City of Coronado v. San Diego Unified Port District, 227 C.A.2d 455, 477-478 (1964) appeal dismissed, 80 U.S. 125 (1965); Cranford Co. v. City of New York, 8 F.2d 52 (2d Cir. 1930). Indeed, state agencies hold heir property for the benefit of all the people of the state, nd, therefore, the question of who pays for the relocation r replacement of such property is a matter of local bookeeping. Fletcher v. Mapes, 62 F.Supp. 351, 353 (N.D. Cal. 945); County of Marin v. Superior Court, 53 C.2d 633, 638-39 (1960); Reclamation District v. Superior Court, 171 Cal. 672, 680 (1916).

Federal courts will not even adjudicate interagency disputes between federal agencies. *United States v. Easement and Right of Way*, 204 F.Supp. 837 (E.D. Tenn. 1962). That was an action brought by the TVA to condemn interests in land, including a security interest held by the FHA. The court dismissed the action, holding that the plaintiff and the defendant were the same person, i.e., the United States,

and that the settlement of interagency problems of the United States Government was not a judicial function. See, also, *The Pietro Campanella*, 47 F.Supp. 374, 378-379 (D. Md. 1942), holding that the federal Alien Property Custodian could not be substituted for the Italian owners of two Italian cargo ships in wartime forfeiture proceedings brought by the United States because, *inter alia*:

"... the situation thus created would make a case impossible for the court to adjudicate. The plaintiff is the United States, and the defendant claimant would be an officer of the United States acting for, on behalf of and in the interest of the United States. Obviously there would be no adverse interests here involved and any adjudication made by the court between these two parties would be a nullity." (47 F.Supp. 379)

A fortiori, federal courts cannot (and should not) adjudicate disputes between state agencies, particularly when such an adjudication would foreclose the procedure established by the state legislature for resolving such disputes. See, People v. Sanitary District of Chicago, 71 N.E. 334 (Ill. 1904), holding that the State of Illinois was not a necessary or proper party to a condemnation proceeding brought by its agency, the sanitary district, because, among other reasons:

"...It would be anomalous that the state, which, through its agent, the sanitary canal, desires to devote certain state property to a public use, should by its agent bring a suit in a state court against itself to determine its own compensation for its own land, devoted to its own use. In the absence of express authority for such proceeding—and none exists—it would be a mere nullity, and would be as valid without as with parties thereto." (71 N.E. 335)

In fact, a federal court will not exercise jurisdiction to control the internal affairs of a private state-created corpora-

tion. Certainly, it should not when the corporation is not only state-created but also is *public* and an agent of the state. See *Pennsylvania v. Williams*, 294 U.S. 176 (1935):

"It has long been accepted practice for the federal courts to relinquish their jurisdiction in favor of the state courts, where its exercise would involve control of or interference with the internal affairs of a domestic corporation of the state." (294 U.S. 185)

Squarely in point is the unreported decision of the court pelow in State of California v. Certain Designated Roads n Butte County, et al., No. 8744 (N.D. Calif. 1964) (CT 222-224).* That was another action brought by DWR to void its obligations under Section 11590, in that case to replace county roads. That action, like this one, was in he court's words, "the outgrowth of a dispute between a tate and a political agency of the State, concerning property held in trust by the agency for the State pursuant to State law, which prescribes a procedure for settling the ispute. See Calif. Water Code §§ 11590 and 11592." The ourt refused to resolve that interagency dispute and disnissed the action. The same result is called for in this case. The present dispute is essentially over which pocket of he state will have to pay for damage done by DWR's ctivities, and that is a proper subject of concern for he state legislature. In Sections 11590-11592 it has dealt vith it. Under settled principles of law, this Court should ot interfere with the provisions so made by the legislature or dealing with the state's internal problems.

^{*}That decision is still good law, notwithstanding the fact that DWR apparently settled that case and obtained a stipulated order rom the Court of Appeals dismissing the case as moot. (CT 317)

V. DWR's Procedural Objections Are Without Merit.

DWR contends that the trial court's opinion was faulty because it failed to make findings which would make clear that DWR could assert its Federal Power Act "claims"—more properly defenses (supra, p. 16) — before there is damage to the Canal (O.B. pp. 17, 51). Since the judgment appealed from granted appellees' motions to dismiss made under Rule 12 of the Federal Rules of Civil Procedure (CT 491-492), no findings of fact at all were required to be made. See, Rule 52(a). In any case, a fair reading of the decision shows that it was based on a broad appreciation of the limits of federal judicial power, as reflected in the Wycoff case, and was not confined to holding that the absence of physical damage alone precluded relief. (Cf. O.B. pp. 17, 21)

Moreover, the District Court went out of its way to set at rest the concerns voiced by DWR on this appeal by stating "that the dismissal of this case is predicated exclusively on the ground that the action has been brought prematurely. Nothing said in this memorandum and order is ever to be construed as in any fashion passing upon the right of any appropriate party in the proper forum to seek relief and/or recover damages—should the situation which [DWR] now asserts may happen, does in fact at some time in the future happen." (CT 445-446)

It is clear therefore that the judgment would not preclude DWR from bringing an action based on a different state of facts—and, inevitably, any state of facts in an action hereafter filed will be different from that alleged in the instant action.

This is all the protection DWR can reasonably ask from this Court or the court below.

CONCLUSION

For the reasons stated, the judgment should be affirmed. Dated April 19, 1968.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this rief, I have examined Rules 18, 19 and 39 of the United states Court of Appeals for the Ninth Circuit, and that, a my opinion, the foregoing brief is in full compliance with hose rules.

WILLIAM W SCHWARZER

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WILLIAM W SCHWARZER



In the

United States Court of Appeals

For the Ninth Circuit

The State of California, Acting by and through the Department of Water Resources,

Appellant,

VS.

THE OROVILLE-WYANDOTTE IRRIGATION DISTRICT, an irrigation district, and the California Public Utilities Commission, a public commission,

Appellees.

Brief of Appellee California Public Utilities Commission

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APR 22 1968



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In the

United States Court of Appeals

For the Ninth Circuit

THE STATE OF CALIFORNIA, Acting by and through the DEPARTMENT OF WATER RESOURCES,

Appellant,

VS.

THE OROVILLE-WYANDOTTE IRRIGATION DISTRICT, an irrigation district, and the California Public Utilities Commission, a public commission,

Appellees.

Brief of Appellee California Public Utilities Commission

STATEMENT OF THE CASE

On October 14, 1966, appellee-Oroville-Wyandotte Irrigation District (OWID) filed an application (Ex. C. to DWR First Amended Complaint, CT 68-72) before the Appellee-California Public Utilities Commission (CPUC) pursuant to Sections 11590-11592 of the California Water Code in which it sought a determination of the obligation, if any, of the Department of Water Resources (DWR), an agency

of the State of California, with respect to the replacement or relocation of OWID's facilities to be taken or destroyed by DWR in the course of the latter's development of the Feather River Project in California. DWR moved to dismiss OWID's application (CT 88-102), which the CPUC denied by order on March 28, 1967 (CT 281-284). Hearing were thereafter held by CPUC on OWID's application, but no final determination has been made as of this date by CPUC.

Even prior to CPUC's order denying DWR's motion DWR commenced the instant action in the United State District Court in which it sought to restrain CPUC from proceeding to entertain OWID's application, and to obtain a declaration that CPUC had no jurisdiction over the subject of OWID's application. CPUC and OWID move to dismisse this action in the Court below and DWR file motions for summary judgment and additional injunctive relief. The District Court denied DWR's motion for injunctive relief and granted the motions to dismisse Further motions by DWR to enjoin CPUC hearing pending the instant appeal were denied by the District Court and this Court.

SUMMARY OF THE ARGUMENT

CPUC believes that it, as a constitutional and statutor agency of the State of California, has an obligation and duty to proceed and hear OWID's application and render a determination thereon pursuant to Sections 11590-1159 of the California Water Code. CPUC also believes that there is no conflict between said Sections 11590-11592 and OWID's application thereunder, and any provision of the Federal Power Act. CPUC also urges that DWR's actic

of the court below was and is premature since CPUC has not made any final determination adverse to DWR and hat DWR has plain, adequate and speedy remedies at law or review any final determination of CPUC. Additionally, considerations of comity, as well as the possible bar of the Eleventh Amendment, require that there be no interference with the CPUC proceeding by the federal courts prior a final state administrative and judicial determination in the CPUC proceeding.

ARGUMENT

CPUC Has a Duty to Proceed to Hear and Determine OWID's Application; Therefore, the District Court Properly Granted Appellees' Motion to Dismiss.

Article XII, Section 23 of the California Constitution rovides in part:

"... (CPUC) shall have and exercise such power and jurisdiction to supervise and regulate public utilities, in the State of California, and to fix the rates to be charged for commodities furnished, or services rendered by public utilities as shall be conferred upon it by the Legislature, and the right of the Legislature to confer powers upon the (CPUC) respecting public utilities is hereby declared to be plenary and to be unlimited by any provision of this Constitution..."

The California Legislature has enacted Sections 11590, 1591 and 11592 of the Water Code of the State of alifornia, which delegate to the Commission the authority and duty to make a determination of the obligation, if any, f DWR, an agency of the State of California, to replace r relocate the facilities of another state agency or public tility taken or damaged by DWR in the development of the of its projects. This is a duty delegated to CPUC which

no other California or federal agency can perform for it. OWID has filed an application pursuant to said Sections 11590-11592 and CPUC is thus under a duty and should be allowed to proceed to make the determination contemplated by the California Legislature.

There is no basis alleged, or in fact, for the District Court (or this Court) to have restrained the CPUC proceeding. DWR has not shown "any threatened or probable act of the (appellees) which might cause the irreparable injury essential to equitable relief by injunction." (Public Serv. Comm. v. Wycoff, 344 U.S. 237, 241.) A court of equity will not enjoin the mere holding of an administrative hearing. (Railroad Commission of Texas v. Pullman Co., 312 U.S. 496; McDevitt v. Gunn, 182 F. Supp. 335; Reinick v. Loper, 77 F. Supp. 333.)

CPUC does not threaten any action that would interfere with DWR's Feather River Project. Its proceeding to make a determination on OWID's application is a lawful exercise of its jurisdiction and does not conflict with any other law.

There Is No Conflict Between the CPUC Proceeding and any Provision of the Federal Power Act.

Sections 11590-11592 of the California Water Code are part of a statutory scheme which also provides for the existence of DWR. These sections are intended to protect other state agencies and local state utilities, and those citizens dependent on their services, affected in the course of DWR projects. These California provisions are entirely compatible with the Federal Power Act.

DWR relies upon the Federal Power Act to invoke federal jurisdiction. But the Federal Power Act does not create or eliminate liability nor does it prescribe a forum for adjudication of liability; it merely preserves existing

remedies against licensees. (16 U.S.C. Sec. 803 (c).) Indeed, with regard to matters like the present one which are concerned with assuring water for irrigation and domestic purposes, the Federal Power Act specifically states:

"Nothing contained in this chapter shall be construed as affecting or intending to affect or in any way to interfere with the laws of the respective States relating to the control, appropriation, use or distribution of water used in irrigation or for municipal or other uses, or any vested right acquired therein." (16 U.S.C. Sec. 821.)

Furthermore, DWR's action is grounded upon the theory that OWID is seeking enforement of rights and duties arising under the Federal Power Act. Upon the facts, this is clearly erroneous. The action of OWID, in its application to CPUC, is strictly based upon the Sections 11590-11592 of the California Water Code. Consequently, there is no justiciable controversy capable of judicial determination regarding the application of OWID. Any determination of the effect of an application predicated on the Federal Power Act would be upon a hypothetical state of facts. (Aetna Life Insurance Co. v. Haworth, 300 U.S. 827.)

Given the true facts about OWID's application, Title 16, U.S.C. Section 825p upon which DWR relies, is not applicable as the application does not rest upon any duty, liability, rule, regulation or order under the Federal Power Act. OWID is seeking rights under the California Water Code. The provisions of the Federal Power Act have been invoked only by DWR and only as defenses to OWID's claim. Such defenses are not a proper basis for federal court intervention and jurisdiction. (Public Serv. Comm. v. Wycoff, supra, 344 U.S. 237; Skelly Oil Co. v. Phillips Co., 339 U.S. 667.)

In support of its contention that the matter is within the purview of federal law, DWR relies primarily on First-Iowa Hydroelectric Cooperative v. Federal Power Commission, 328 U.S. 152. This case is clearly distinguishable from the present situation. In the First-Iowa case, a state statute required approval of the state prior to commencement of work on a dam and electric project. The applicant in that case sought a license from the Federal Power Commission (FPC) and the state contended that the licensee must also show compliance with the state laws regarding construction of the dam and power site, prior to obtaining a permit from the FPC. The Court held that the Federal Power Act did in that instance supersede the state law as it was clearly in direct conflict with the FPC action and provisions of the Federal Power Act. Here, there is no conflict or interference with the Federal Power Act or the FPC. Any action taken by CPUC would merely determine who has the obligation under the California Water Code with respect to the relocation of certain of OWID's facilities. However, there is nothing in OWID's application before the CPUC, nor any suggestion of any prospective action of the CPUC, that either OWID seeks, or the CPUC intends to interfere with any FPC action or Federal Power Act statute.

CPUC Has Not Made a Final Determination; DWR's Contentions Are Premature, Its Rights Protected by Adequate Judicial Remedies.

CPUC has not made a final determination of OWID's application. When such a determination is made, if DWR considers its rights to have been adversely affected, DWR will have adequate remedies at law to raise any jurisdictional arguments, namely, by petition for rehearing before CPUC and then by petition for review directly to

the California Supreme Court. (Section 1731, et seq. and 1756, et seq., Calif. Pub. Util. Code.) DWR, if still dissatisfied, may then directly seek review before the United States Supreme Court. (28 U.S.C. Sec. 1257.)

The District Court's Action Should Also Be Sustained on Grounds of Comity.

DWR seeks in the instant proceeding to restrain a constitutionally created agency of the State of California from performing its lawful function. As we have seen, CPUC has not as yet made a final determination on OWID's application. DWR has plain, adequate and speedy judicial remedies to test the validity of any CPUC decision in the California Supreme Court. On this basis, the exercise of federal jurisdiction, even if applicable, should be withheld on consideration of comity since California law provides for judicial review of any CPUC order and for its stay pending review. (Alabama Pub. Serv. Com. v. Southern R. Co., 341 U.S. 341.)

Furthermore, the fact that the action is against agencies of the State of California also raises the bar of the Eleventh Amendment. The language of that amendment prohibits federal court suits brought against a state by citizens of another state, but it has been construed to prohibit federal court suits against a state brought by citizens against the state of which they are citizens as well. (Parden v. Terminal R. of Alabama Docks Dept., 377 U.S. 184, 186; Hans v. Louisiana, 134 U.S. 1; Fitts v. McGhee, 172 U.S. 516, 524-25; North Carolina v. Temple, 134 U.S. 22, 30.) A fortiori, it prohibits suits by one state agency against a sister state agency.

CONCLUSION

For the foregoing reasons, the judgment of the District Court should be affirmed.

Dated: April 22, 1968.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

TIMOTHY E. TREACY

IN THE

MA. LYOLT) UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

THE STATE OF CALIFORNIA, Acting by and through the DEPARTMENT OF WATER RESOURCES.

Appellant.

VS.

THE OROVILLE-WYANDOTTE IRRI-GATION DISTRICT, an irrigation district, and the CALIFORNIA PUBLIC UTILI-TIES COMMISSION, a public commission. Appellees.

APPELLANT'S REPLY BRIEF

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IN THE

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

THE STATE OF CALIFORNIA, Acting by and through the DEPARTMENT OF WATER RESOURCES,

Appellant,

VS.

THE OROVILLE-WYANDOTTE IRRI-GATION DISTRICT, an irrigation district, and the CALIFORNIA PUBLIC UTILI-TIES COMMISSION, a public commission, Appellees.

APPELLANT'S REPLY BRIEF

ı

STATEMENT OF THE CASE

OWID offers this court, under the guise of a new statement of the case, additional facts concerning the approval of Project 2088 by various state agencies and prior negotiations between DWR and OWID (OWID 2-3). These facts and the conclusions to be drawn from them are subject to dispute. Further, and most significant, they are not relevant to the issue of who has jurisdiction to determine this matter, nor to the propriety of injunctive or declaratory relief.

By recitation of these additional facts OWID endeavors to argue the issue of liability, relying heavily on the theory of estoppel. Unfortunately, the merits of this issue are not before this court for review.

We submit that the facts relevant to the issues raised by this appeal are set forth in DWR's statement of the case and are undisputed.

Ш

ARGUMENT

A. Summary

OWID and CPUC characterize this dispute as one in the nature of condemnation, request that this court exercise comity, and assert that this action is barred by Section 27 of the Federal Power Act, the Eleventh Amendment of the United States Constitution, and the status of DWR, OWID and CPUC as agencies of the State of California. Further, OWID and CPUC assert that the FPC has no jurisdiction over the issue of liability.

This is not a dispute in the nature of condemnation. This is a dispute over the obligation of an FPC licensee, OWID, to comply with and assume the economic burden of duties, orders, and regulations imposed by the Federal Power Act and the FPC.

This is not a proper case for the exercise of comity. CPUC has no regulatory authority over OWID, and Water Code Sections 11590-11592 do not purport to accord CPUC such broad regulatory authority over

DWR as to justify the exercise of comity under the holding of Alabama Public Service Commission v. Southern Railway Company, 341 U.S. 341 (1951).

Section 27 of the Federal Power Act is not relevant to this dispute. This dispute does not involve any interference with a water right or raise any issue over the allocation of waters of the South Fork of the Feather River as between Projects 2100 and 2088.

This type of action is not barred by the Eleventh Amendment. Alabama Public Service Commission v. Southern Railway Company (supra). Neither is it barred because the parties thereto are state agencies. Section 317 of the Federal Power Act does not exempt from its provisions, either expressly or implicitly, disputes between FPC licensees that are public agencies of the same state.

Whether or not the FPC has authority to determine the issue of liability is not relevant to this dispute. Any authority that does exist is, clearly, held either by the FPC, or the District Court under Section 317 of the Federal Power Act, or both. DWR does not ask this court to determine as between the FPC and the District Court which has partial or complete jurisdiction over the issue of liability. DWR asks only that this court declare that CPUC has no jurisdiction over this issue, or any other issue raised by this dispute. DWR requests this court to direct the District Court to stay proceedings on the issue of liability until the authority of the FPC on this issue has been determined by judicial review.

B. This Dispute Is Erroneously Characterized By Appellees
As One In The Nature Of Condemnation; It Is Not; It Is
A Dispute Over The Obligation Of OWID As An FPC
Licensee To Comply With Duties, Orders, And Regulations Imposed By The Federal Power Act And FPC,
And The Authority Of CPUC To Vary Such

OWID endeavors to characterize this dispute as one in the nature of condemnation. It states (OWID 19):

"Clearly, one whose reservoir impairs or destroys another's property would, under general principles of law, be liable to that person. Section 10(e) simply confirms that this liability survives issuance of the license. See Ford and Son v. Little Falls Fibre Co., 280 U.S. 369 (1930).

"That is what OWID is concerned with in the CPUC proceedings."

Based on this characterization OWID urges that CPUC has jurisdiction of this dispute, citing as authority condemnation cases involving issues of compensation (OWID 20) and local policy (OWID 33).

Based on this characterization CPUC blandly asserts (CPUC 5):

". . . DWR's action is grounded upon the theory that OWID is seeking enforcement of rights and duties arising under the Federal Power Act. Upon the facts, this is clearly erroneous. The action of OWID, in its application to CPUC, is strictly based upon the Sections 11590–11592 of the California Water Code."

If this is a condemnation dispute it is clear that local statutes, such as Water Code Sections 11590-11592 cannot qualify an FPC licensee's right to bring an ordinary condemnation action in a federal district court pursuant to Section 21 of the Federal Power Act, 16 U.S.C. 814. Beezer v. City of Seattle, 62 Wash. 2d 569, 383 P.2d 895 (1963); reversed, City of Seattle v. Beezer, 376 U.S. 224 (1964). However, this is not a condemnation dispute. First, it is a dispute over the obligation of an FPC licensee, OWID, to comply with duties, orders, and regulations imposed by the Federal Power Act and the FPC. Second, it is a dispute over the jurisdiction and authority of a state agency, CPUC, to shift the economic burden of these duties, orders, and regulations to another FPC licensee, DWR. Third, it is a dispute over the jurisdiction and authority of CPUC to determine what modifications, if any, are required to make one FPC licensed project compatible with another.

With respect to the first and second points, above, this dispute is analogous to that involved in Big Horn Power Co. v. State, 23 Wyo. 271, 148 Pac. 1110 (1915) and the related case of Clarke, et al v. Boysen, et al, 39 F.2d 800 (C.A. 10th 1930). In the Big Horn case the defendant (Big Horn) had been granted a license by the state engineer to construct a dam to a specified height. The dam was constructed higher than licensed and as a result interfered with the plans of the Burlington Railroad to construct a railway in the gorge

behind the dam, the very conflict which the height limitation in Big Horn's license was intended to avoid.

The state successfully prosecuted an action to compel Big Horn to modify the dam. The dam was not modified and in *Clarke*, et al v. Boysen, et al the Burlington Railroad sought to quiet Burlington's title to the right-of-way for the railway and to compel Clarke and others, owners of interests in the dam constructed by the Big Horn Power Company, to modify the dam.¹

Burlington prevailed in the lower court. On appeal, counsel for Clarke sought to characterize the decision of the lower court as authorizing condemnation of land devoted to a public use. The court stated (pp. 815–816):

"The theory of counsel for Clarke is that the land was already devoted to public use and that the Burlington Company could not condemn such land under its power of eminent domain.

"The right-of-way does not impair the use of the lawful portion of the dam structure and the protection of the Burlington Company's rights and interests therein will in no wise impair or interfere with the use of such lawful portion. The fact that the protection of the rights and interests of the Burlington Company in such right-of-way will interfere with the maintenance of the unlawful portion of the dam structure, in our opinion, is not material." (Emphasis added.)

¹ The decision in the *Clarke* case dealt with several appeals dealing with various issues. Our comments are limited to that portion of the decision dealing with cause No. 1513 which is discussed on pages 813–821 of 39 F.2d.

Counsel for Clarke also sought to invalidate the lower court's decision on the theory of estoppel. The court stated (p. 818):

"Counsel for the Clarke group further contend that the Burlington Company is estopped to complain of such superstructure and narrow spillway as a nuisance, because the dam and superstructure were constructed and completed before the construction of the railway.

"The Burlington Company's predecessor, the Big Horn Railroad Company, filed its application for its right-of-way in March, 1905. When application was made to the state engineer for the approval of a dam 60 feet in height, the Burlington Company protested and the state engineer limited the height of the dam to 35 feet and approved the plans for a dam 35 feet in height with a spillway 125 feet long. Under these facts, the Burlington Company clearly had the right to construct its railroad on its right-of-way and to rely upon its right to require the dam to be modified to conform to a lawful structure." (Emphasis added.)

The Big Horn and Clarke cases illustrate that the regulation of OWID by the FPC, and the responsibilities of OWID under the Federal Power Act, do not create a condemnation dispute merely because such regulations and responsibilities might enure to the benefit of DWR. In the court's own words (39 F.2d at page 816):

"The fact that the protection of the rights and interests of the Burlington Company in such right-of-way will interfere with the maintenance of the unlawful portion of the dam structure, in our opinion, is not material."

Further, these cases illustrate the relevance of the property rights held by DWR in the lands of the United States set aside for DWR's Project 2100. OWID would have this court completely disregard this issue. At page 14 of its brief OWID states:

"... it is clear that if the FPC fails to find violations (as we think it must), DWR's entire argument collapses."

It is, apparently, OWID's position that if OWID did not violate the provisions of the Federal Power Act in the design and construction of the Miners Ranch Canal, DWR has no rights under the Federal Power Act arising from the power withdrawal effected by DWR's license. As noted at page 5 of DWR's opening brief, a portion of the Miners Ranch Canal is located on lands belonging to the United States which were withdrawn and reserved by the United States for DWR's Project 2100 before OWID sought licensing for the Miners Ranch Canal. At page 43 of its opening brief DWR emphasized that one of the central issues in this dispute is the rights and obligations that arise from the occupancy of federal lands, an issue over which CPUC, clearly, has no jurisdiction. At page 53 of its opening brief, DWR specifically requested this court to direct the District Court to

proceed to trial, after judicial review of the FPC decision, on the issue raised by paragraph 1e of DWR's prayer for declaratory relief as to DWR's rights in lands belonging to the United States reserved and withdrawn for its Project 2100 (CT 64/5-13).

C. CPUC Has No Comprehensive Regulatory Authority Over OWID Or DWR Justifying The Exercise Of Comity

Reliance is placed by OWID (OWID 30, 32) and CPUC (CPUC 7) on Alabama Public Service Commission v. Southern Railway Company, 341 U.S. 341 (1951), and Burford v. Sun Oil Co., 319 U.S. 315 (1943). In those cases the Supreme Court emphasized the broad regulatory authority accorded the state commissions by state law, and the availability of judicial review as a matter of right.

As DWR noted in its opening brief (page 36), CPUC has no authority to regulate the design, construction, or operation of OWID's or DWR's projects. Indeed, California statutes will be searched in vain to find any authority in CPUC to regulate any of the activities of OWID or DWR.

OWID's attempt to accord CPUC regulatory authority over OWID (OWID 32, footnote) is sheer sophistry. In *Henderson* v. *Oroville-Wyandotte Irrigation District*, 207 Cal. 215 (1929), cited by OWID, the court expressly recognized that the Railroad Commission, CPUC's predecessor, had no jurisdiction to regulate OWID in the development and operation of its facilities. The court stated (at page 219):

"The further contention of respondent seems to be that inasmuch as the Railroad Commission admittedly is without supervisory power over defendant Irrigation District (Jochimsen v. City of Los Angeles, 54 Cal.App. 715 [202 Pac. 902]; City of Pasadena v. Railroad Com., 183 Cal. 526 [10 A.L.R. 1425, 192 Pac. 25]; Lindsay-Strathmore Irr. Dist. v. Superior Court, 182 Cal. 315 [187 Pac. 1056]; Water Users etc. Assn. v. Railroad Com., 188 Cal. 437 [205 Pac. 682]), "

If CPUC had no authority to regulate the facilities of OWID as they existed at that time, 1929, a fortiori it has no authority to regulate new facilities constructed 30 years later such as those of OWID's FPC Project 2088. We note that although OWID sets forth (OWID 2) various actions taken by state agencies in connection with the development of FPC Project 2088, no reference is made to any action taken by CPUC. Further, not even CPUC ascribes to itself any regulatory authority over OWID.

The sole authority on which CPUC bases its actions is Water Code Sections 11590–11592. These provisions do not accord CPUC regulatory authority of the type possessed by the state commissions in the *Alabama* and *Burford* cases. It is the FPC which is accorded broad regulatory authority over both OWID and DWR. It is the FPC which has authority to determine which projects are best adapted to a comprehensive plan for the improvement and utilization of waterpower development. It is the FPC which must evaluate the

economic feasibility, including the cost of construction and operation, of each project in relation to the other.

Although CPUC asserts (CPUC 6) that DWR has a right to adequate judicial review pursuant to state law, the fact is DWR has no such right at all, and the only possible review it may have is totally dissimilar to that afforded by the states of Alabama and Texas, discussed in the Alabama and Burford cases. In California, judicial review of CPUC decisions is subject to discretionary grant or denial and is by certiorari, not by direct appeal as provided by the Alabama and Texas statutes. California Public Utilities Code §§ 1756 and 1759.²

Further, the very cases cited by OWID (OWID 24) demonstrate that the California Supreme Court has consistently denied review of CPUC actions under Water Code Sections 11590–11592. Feather River Railway Co., 61 P.U.C. 728 (1963), writ of review denied, August 12, 1964; County of Butte, 62 P.U.C. 537 (1964), writ of review denied, March 1965. The adverse effect that such denial would have in the present action before CPUC is discussed at length in DWR's opening brief (DWR 41–43).

We submit that if there was ever a dispute less deserving of the exercise of comity, this is it. Indeed, it is CPUC, not this court, which should be exercising comity rather than doggedly pursuing a parochial policy which can only prolong this litigation and postpone the time when such modifications as may be

² These sections are set forth in full in the Appendix.

necessary to the Miners Ranch Canal can be ordered and those orders enforced.

D. Section 27 Of The Federal Power Act Is Not Relevant To The Issues Before This Court

Both OWID (OWID 32) and CPUC (CPUC 5) urge that Section 27 °s of the Federal Power Act, 16 U.S.C. 821, reserves to CPUC jurisdiction over this dispute. The purpose of Section 27 is to preserve state laws defining proprietary rights in water. First Iowa Hydro-Electric Cooperative v. Federal Power Commission, 328 U.S. 152, 175–176 (1946). Cf. Fresno v. California, 372 U.S. 627 (1963). This dispute does not involve any interference with a water right. There is no dispute over the allocation of the waters of the South Fork of the Feather River as between FPC Projects 2100 and 2088.

None of the issues before the FPC involve the resolution of water rights, and, clearly, none of the issues before CPUC involve resolution of such rights either. Further, CPUC has no authority under Water Code Sections 11590–11592 to resolve a water right dispute, even if one existed. Nothing in these sections grants CPUC any authority over the control, appropriation, use, or distribution of water.

The reference to Section 27 is but another example of Appellees' misleading use of a condemnation theory. This dispute does not involve the condemnation of rights in water. Again, it involves the duty of OWID

³ OWID's reference to Section '28' is, apparently, a typographical error.

to fulfill its obligation under its power license to design, construct, and operate its facilities in accordance with the duties, regulations, and orders imposed by the Federal Power Act and the FPC.

E. This Action Is Not Barred By The Eleventh Amendment Or By The Fact That It Involves A Dispute Between Public Agencies Of The Same State

CPUC asserts that this litigation is barred by the Eleventh Amendment of the United States Constitution (CPUC 7). This assertion is totally without merit. It was rejected by the United States Supreme Court in the very case on which CPUC and OWID base their plea for comity: Alabama Public Service Commission v. Southern Railway Co., 341 U.S. 341 (1951). In that case the court states (footnote 4, page 344):

"Appellants contend for the first time in this Court that a suit to restrain state officials from enforcing unconstitutional state laws is, in effect, a suit against the state prohibited by the Eleventh Amendment. The contention is not tenable in view of the many cases prior to and following Ex parte Young, 209 U.S. 123 (1908), in which this Court has granted such relief over the same objection."

OWID states that the Federal Courts will not adjudicate interagency disputes between federal agencies and concludes that "a fortiori federal courts cannot (and should not) adjudicate disputes between state agencies." (OWID 33-34). On the basis of this conclusion, OWID would, apparently, have this court interpret Section 317 of the Federal Power Act, 16

U.S.C. 825 p, to be inapplicable to disputes between two FPC licensees which are public agencies of the same state.

In support of its conclusion OWID cites two cases: United States v. Easement and Right of Way, 204 F.Supp. 837 (E.D.Tenn. 1962) and The Pietro Campanella, 47 F.Supp. 374 (D.Md. 1942). Neither of these cases involve the Federal Power Act.

In the *United States* case the only authority cited by the court in support of the proposition that resolution of a dispute between two federal agencies is not a judicial function is *United States Department of* Agriculture, etc. v. Remund, 330 U.S. 539 (1947).

In the *Remund* case the issue was whether a claim of the Farm Credit Administration had priority under federal law in a state probate proceeding. It was asserted that it did not have such priority because the Farm Credit Administration was an entity separate and distinct from the United States. The court held it was not such a separate entity.

It appears that in *United States* v. *Easement and* Right of Way the court used the Remund case only for the proposition that the TVA and FHA were not entities separate and distinct from the United States Government. The court cited no authority for the proposition that these two agencies could not sue one another.

In the *Pietro Campanella* case the issue was whether the Alien Property Custodian should be granted broad authority to represent the owners of two enemy cargo ships in a libel filed by the United States for the forfeiture of these ships. The court emphasized its belief that an enemy defendant should be permitted to defend his property in court. To reach that result the court found that a suit against the Alien Property Custodian would be a suit against the United States, citing authorities, and concluded that there would thus be no adverse interests involved and the adjudication would be a nullity, citing no authorities.

We believe it incredible that OWID should imply that Section 317 of the Federal Power Act is qualified by these two cases. Further, agencies of the United States have successfully prosecuted actions against one another. In *United States* v. *Interstate Commerce Commission and United States*, 337 U.S. 426 (1949) the Supreme Court held that despite the fact that the United States was both plaintiff and defendant, there was present, as here, an actual case and controversy involving no bad faith or collusion, a case presenting the adversary viewpoints and contentions of actual interested parties. It held that maintenance of the action was not barred by the principle that one may not be both plaintiff and defendant in the same action.

In California there has never been any question that suits may be maintained between state agencies. People of the State of California v. Board of Supervisors of the County of San Luis Obispo, 50 Cal. 561 (1875); State of California, by E. P. Calgan, State Controller v. County of Sonoma, 139 Cal. 264 (1903);

County of San Bernardino v. State Board of Equalization of the State of California and Pacific Fruit Express Company, 172 Cal. 76 (1916); State Board of Health of the State of California v. County of Alameda, 42 Cal.App. 166 (1919).

At pages 34 and 35 of its brief OWID states that this court should not interfere with the internal affairs of a public agency created by the state. In support of this proposition it cites *Pennsylvania* v. *Williams*, 294 U.S. 176 (1935), and the unreported case of *State of California* v. *Certain Designated Roads in Butte County*, et al, N.D. Calif. 1964, vacated and dismissed C.A. 9th 1966 (CT/317).

Contrary to OWID's representation, the State of California case is not good law. United States v. Munsingwear, 340 U.S. 36 (1950). In the Pennsylvania case the court stated (294 U.S. at page 182):

"The relief sought, an injunction and the appointment of receivers, was aimed at the prevention of irreparable injury, from the waste of the assets of the insolvent corporation which would ensue from a race of creditors to secure payment of their claims by forced sale of the corporate property. By local statutes elaborate provision is made for accomplishing the same end, through the action of a state officer, in substantially the same manner and without substantially different results from those to be attained in receivership proceedings in the federal courts."

We submit that Water Code sections 11590-11592 are in no way intended to resolve the issues in this

dispute, and the policy set forth in the *Pennsylvania* case is clearly inapplicable. Further, the "internal affairs" to which OWID refers is the accommodation of one FPC licensed project to another. It has been consistently held that the standards and design pursuant to which FPC licensed facilities are authorized, constructed, and operated are not subject to local control. City of Tacoma v. Taxpayers of Tacoma, 357 U.S. 320 (1958); Public Utility District No. 1 v. Federal Power Commission, 308 F.2d 318 (1962), cert. denied 372 U.S. 908 (1963).

F. The Absence Of Any Authority In The FPC To Determine Issues Of Liability Confers No Authority On CPUC Over These Issues

At page 20 of its brief OWID urges that the FPC has no authority to determine questions of liability of FPC licensees. It is, apparently, OWID's position that in the absence of such authority, there can be no conflict between Water Code Sections 11590–11592 and the Federal Power Act. This is also the position of CPUC, for its states (CPUC 4):

"DWR relies upon the Federal Power Act to invoke federal jurisdiction. But the Federal Power Act does not create or eliminate liability nor does it prescribe a forum for adjudication of liability; it merely preserves existing remedies against licensees."

The issue of liability is twofold. There is the issue of OWID's liability to comply with the regulations and orders of the FPC, and there is the issue of

DWR's liability under the Federal Power Act for the cost of OWID's compliance with the orders and regulations of the FPC. Section 317 of the Federal Power Act, which OWID totally and CPUC virtually ignore, does not distinguish between these two types of liability but states simply:

"The District Courts of the United States . . . shall have exclusive jurisdiction of . . . all suits in equity and actions at law brought to enforce any liability or duty created by . . . the Act"

It is clear that if the FPC has no authority to determine either of the above issues of liability, that authority is vested exclusively in the District Court, not CPUC. For this reason the FPC's authority over the issue of liability is completely irrelevant to the issues before this court under this appeal.

DWR has not requested that this court determine as between the FPC and the District Court which should determine the issue or issues of liability. DWR specifically requested that this court direct the District Court to stay proceedings on the issues of liability until the FPC has acted, and its authority as to these issues tested by judicial review. We submit that this procedure is orderly, protects both the rights of OWID and DWR, and permits resolution of all issues raised in this dispute.

Ш

CONCLUSION

For the reasons stated herein, and in DWR's opening brief, DWR submits that this court should grant the relief requested in Section V of its opening brief (pages 53-54).

Dated: May 7, 1968.

Respectfully submitted,

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CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

RICHARD D. MARTLAND Deputy Attorney General

APPENDIX

Statutes of the State of California

Public Utilities Code Section 1756:

"Within 30 days after the application for a rehearing is denied, or, if the application is granted, then within 30 days after the decision on rehearing, the applicant may apply to the Supreme Court of this State for a writ of certiorari or review for the purpose of having the lawfulness of the original order or decision or of the order or decision on rehearing inquired into and determined. The writ shall be made returnable not later than 30 days after the date of issuance, and shall direct the commission to certify its record in the case to the court. On the return day, the cause shall be heard by the Supreme Court, unless for a good reason shown it is continued."

Public Utilities Code Section 1759:

"No court of this State, except the Supreme Court to the extent specified in this article, shall have jurisdiction to review, reverse, correct, or annul any order or decision of the commission or to suspend or delay the execution or operation thereof, or to enjoin, restrain or interfere with the commission in the performance of its official duties, except that the writ of mandamus shall lie from the Supreme Court to the commission in all proper cases."

No. 22127/

THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

ELEANOR R. JESS,

Appellant,

vs.

GREAT NORTHERN RAILWAY COMPANY, A Corporation,

Appellee.

BRIEF OF APPELLANT

FILED

OCT 23 1967

WM. B. LUCK, CLERK

TIPP, HOVEN & BRAULT and GORDON E. HOVEN 123 West Broadway Ave. Missoula, Montana Attorneys for Plaintiff and Appellant

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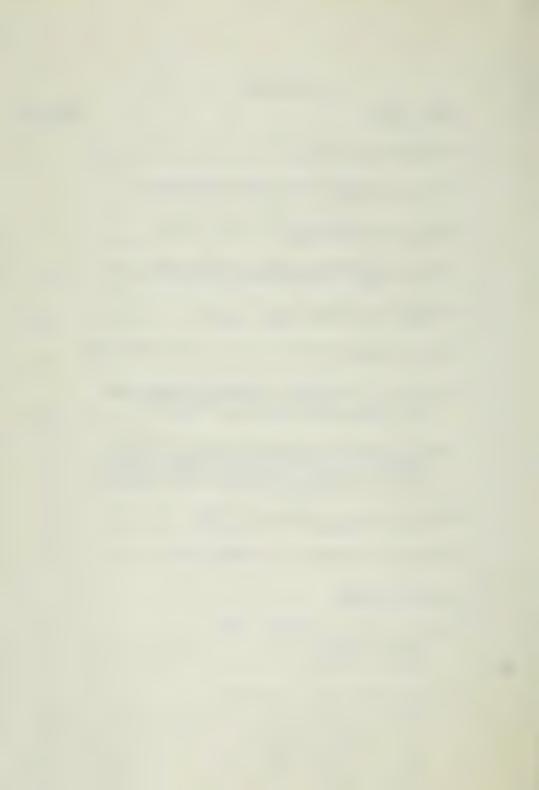
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FEDERAL JURISDICTION

The jurisdiction of the District Court is based on diversity of citizenship in a controversy involving more than Ten Thousand Dollars (\$10,000.00). The cause was originally instituted in Cascade County Montana, and removed to the U. S. District Court by the defendant on the grounds of diversity of citizenship, the plaintiff being a resident of the State of Montana, and the defendant corporation existing under and by virtue of the laws of the State of Minnesota. Thus, jurisdiction clearly exists under Title 28, Section 41 US Code Ann.

II.

STATEMENT OF CASE

The plaintiff filed the cause in Cascade

County Court, Montana, wherein she sought damages for

the deprivation by the defendant of the services, com
fort, happiness, and the society and companionship of

her husband by virtue of negligence of the defendant.

In other words, a loss of consortium.

On January 18, 1967, after the removal of the case to the United States District Court for the District of Montana, Great Falls Division, the defendant filed a Motion to Dismiss under the Federal Rules



of Civil Procedure, Rule 12 (b) on the grounds that the Complaint failed to state a claim against the defendant upon which relief might be granted.

At about the same time, the defendant sought admissions from the plaintiff, all of which were subsequently admitted and which, in substance, set forth that the husband of the plaintiff, Don Jess, had instituted an action under the Federal Employer's Liability Act, wherein he sought damages for negligence of the defendant railroad, and which was resolved in favor of the defendant railroad.

On May 26, 1967, the Honorable Russell E. Smith, Judge presiding in the District Court, rendered his opinion and order to the effect that the Motion to Dismiss would be granted and the Court directed that all relief be denied to the plaintiff. As a result thereof, on the 6th day of June, 1967, Judgment of Dismissal was entered by the defendant against the plaintiff and appellant.

III.

SPECIFICATION OF ERROR

The lower Court erred in granting the Motion to Dismiss and directing that Judgement be entered against the defendant.



ARGUMENT

The Complaint, in substance, alleges that the plaintiff is the wife of Don Jess; that Don Jess was injured on January 12, 1965, while in the employ of the Great Northern Railroad; that the injury to her husband was a result of the negligence on the part of the defendant and as a result thereof, she was deprived of the companionship, society, services and comfort of her husband.

A. LOSS OF CONSORTIUM

The question that arises whether or not there exists in the State of Montana, a right in the plaintiff to sue for such losses as is generally found under the phrase "loss of consortium". While the lower Court in its order and opinion used the phrase, "conceding that the wife in Montana may ordinarily sue for loss of consortium" we deem it necessary to cite the law of the State of Montana so that this Court may understand that under the Montana Law there is no question, whatsoever, as to the rights of the wife to institute and prosecute as such a cause.

In the case of <u>Duffy vs. Lipsman</u>, <u>Fulkerson</u>
& Co., 200 Federal Supplement 71 (1961) the Court
there had the question directly presented to it and



said at page 72 thereof,

"Defendant's Motion to Dismiss is based upon contingent that under Montana law, a wife has no action for loss of consortium when such loss is a result of negligent injury to her husband."

The Court concluded that while there was no statute in Montana giving the wife a cause of action for loss of consortium, that the Montana Supreme Court had not passed on that question, there was, and is such a cause of action in Montana. The cause of action is divided into two parts:

1. The right that as set forth in 48-101 Revised Codes of Montana, 1947:

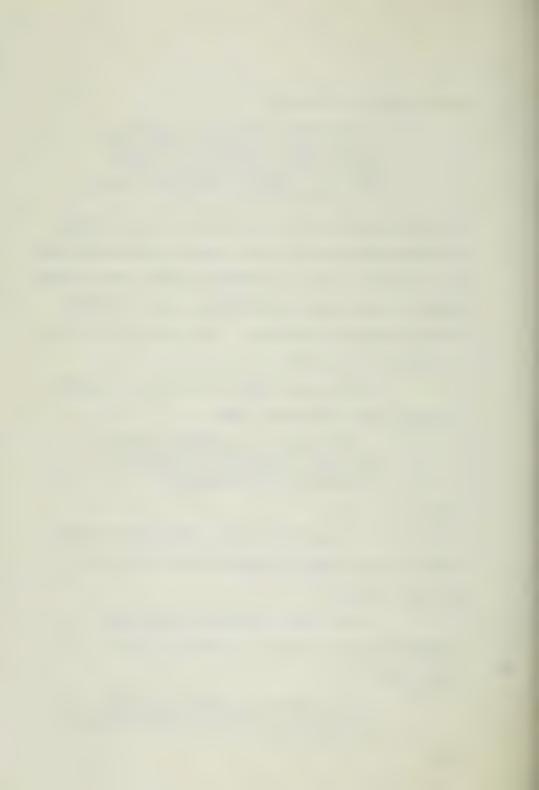
"Marriage is a personal relation arising out of a civil contract, to which the consent of parties capable of making it is necessary..."

and,

2. The Second part, which is an infringement of those rights as therein set forth in the sections quoted.

In the case of <u>Wallace vs. Wallace</u>, 85
Montana 492; 279 Pac 374; 66 ALR 587, (1929) the
Court said;

"In addition to support, a wife is entitled to the aid, protection, affection, and society of her husband,"



"... the husband's right to recovery for loss of consortium of his wife due to negligence was well recognized at common law. See annotation in 21 ALR 1519."

The Married Woman's Act, as enacted in the State of Montana and set forth in Section 36-110 of Revised Codes Montana, 1947:

"A married woman in her own name may prosecute action for her reputation, person, property and character, or for the enforcement of any legal or equitable right and may in like manner defend any action brought against herself."

and Section 36-128, Revised Codes Montana, 1947:

"A married woman may sue and be sued in the same manner as if she were sole."

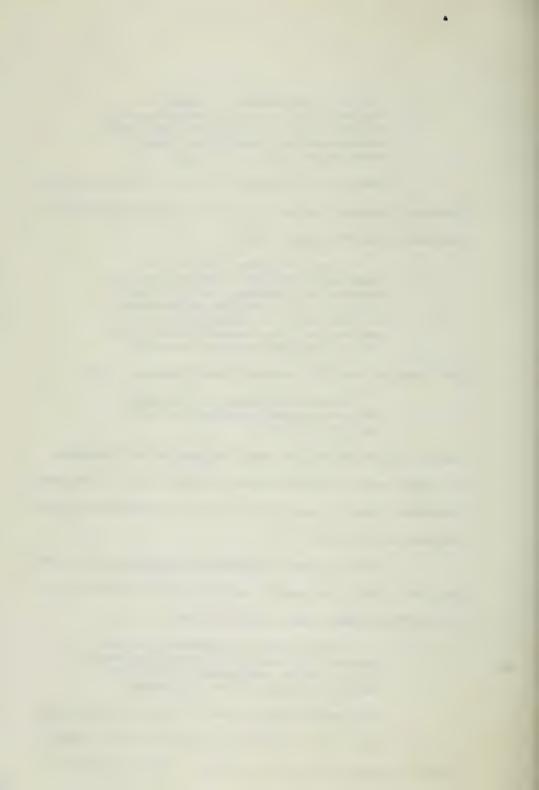
places the wife on the same footing as her husband.

In other words, the wife has, in the State of Montana,
the same right to sue for a loss of consortium as the
husband would have.

In the case of <u>Dutton vs Hightower</u> 214 Fed Sup 298 (1963) the court reaffirmed its decision in the Duffy-Lipsman case, supra, that;

"A wife has the right to recover damages for loss of consortium resulting injuries negligently inflicted on her husband by the defendant."

We respectfully submit that the concession as set forth in the opinion and Order by the lower Court is entirely correct inthat a wife in Montana



may sue for loss of consortium.

B. EFFECT OF FELA

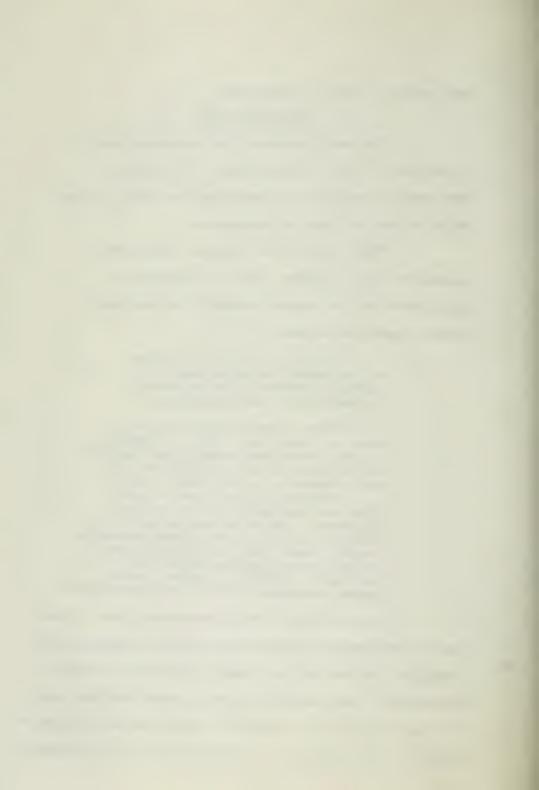
The next question that presents itself is whether or not the enactment of the Federal Employer's Liability Act destroys the right in the wife to sue for loss of consortium.

That part of the Federal Employer's Liability Act, 45 USCA, Sec. 51, insofar as applicable to the issues presently before this Court, reads as follows:

"Liability of common carriers by railroad, in interstate or foreign commerce, for injuries to employees from negligence; ...

"Every common carrier by railroad ... shall be liable in damages
to any person suffering injury while
he is employed by such carrier in
such commerce ... for such injury
... resulting in whole or in part
from the negligence of any of the
officers, agents, or employees of such
carrier, or by reason of any defect or
insufficiency, due to its negligence
in its cars, engines, appliances,
machinery, traffic, roadbed, works,
boats, wharves, or other equipment.***

It is to be clearly understood from a reading of the Complaint that the plaintiff does not contend that her action is brought under the foregoing enactment. The plaintiff is suing under Montana Law, for her loss of consortium resulting from her husband's injuries occasioned by the negligence of the defendant.



This claim is the plaintiff's personal and separate claim. The fact that the plaintiff's husband could, and did, bring an action under the Federal Employer's Liability Act, has no effect upon the rights of the plaintiff. It is a claim personal to the plaintiff and quite independent of any claim that her husband might have under the FELA.

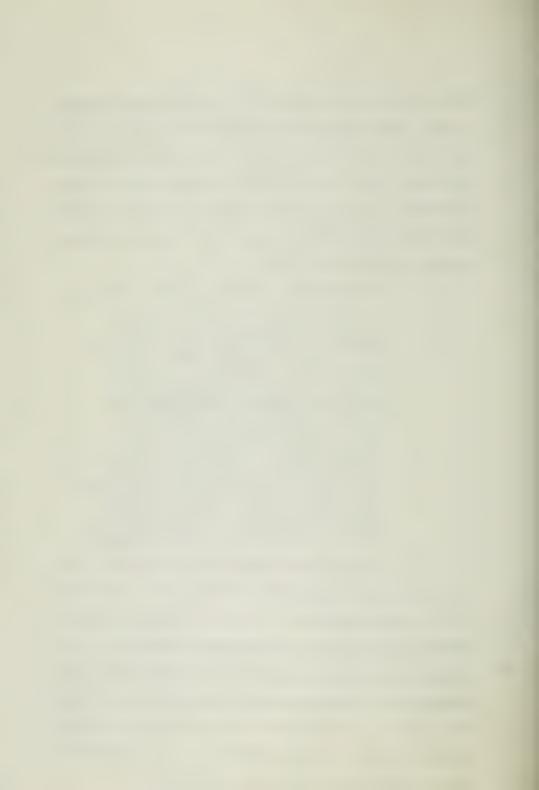
We quote from the FELA 45 USCA, Sec. 51:

"Every common carrier ... shall be liable in damages to any person suffering injury while he is employed by ... (an interstate) carrier in (interstate) commerce, or, in case of the death of such employee, to his or her personal representative, for the benefit of the surviving widow or husband and children of such employee; and, if none, then of such employee; and, if none, then of such employee's parents; and if none, then of the next of kin dependent upon such employee for such injury or death resulting in whole or in part from the negligence (of the said common carrier) *** ." (emphasis added.)

The next important decision at about the same time and in the year 1917 came about by virtue of the consolidation of two cases of the New York

Central and Hudson River Railroad Company vs.

Tonsellito, an infant, and The New York Central and Hudson River Railroad Company vs. Tonsillito, 244 US 361 (1917). In the course of our discussion we will generally refer to this citation as the Tonsellito case. The facts briefly are as follows:



"A minor had been employed in interstate tasks by a railroad engaged in interstate commerce. The minor was injured. The father of the minor brought two actions: one for damages on behalf of his son, and the other was brought by the father on his own behalf to recover the loss of his son's services and for medical expenses incident to the injuries his minor son had received. The United States Supreme Court affirmed the father's recovery of damages on behalf of the son but reversed the award to the father for the father's damages for loss of his son's services and the medical expenses. In denying the father's right to recover on his own behalf the Court used language to the effect that the remedies provided by F.E.L.A. were the only remedies which could be used by any and all persons to recover from railroad when the injuries arose out of tasks in interstate commerce. The Court went on to say at page 361 that:

"The act is comprehensive and also exclusive in respect of a railroad's liability for injuries suffered by its employees while engaged in interstate commerce. It establishes a rule or regulation which is intended to operate uniformly in all the States, as respects interstate commerce and in that field it is both paramount and exclusive, Congress having declared when, how far, and to whom carriers shall be liable they can neither be extended nor abridged by common or statutory laws of the State."

We discuss the Winfield and Tonsellito decisions because of the fact that in the Winfield case, the lower Court cites the Tonsellito case as authority for its decision.



In the case of Louisville & Nashville Railroad Co. and others, vs. Lundsford, 216 Georgia 289,
116 South Eastern Second 232 (1960) the Georgia Supreme
Court, we submit, was mistaken in its thinking that the
only question presented was;

"Whether a wife may sue for loss of consortium occasioned by an injury which her husband, an Interstate employee of a Railroad Company, sustained in consequence of his employer's negligence as against the defendant's contention that the Congress, in passing the FELA preempted that field of legislation and excluded all remedies which might be resorted to for injuries to employees other than those provided for by such act."

"The Court decided that FELA pre-empted <u>all</u> state remedies which anyone might resort to for damages arising from injuries to employees employed in interstate tasks by a railroad operating in interstate commerce.

"The George Court in this opinion continued the misinterpretation of the Winfield decisions first committed in the Tonsellito decision and added a new error of its own. In the Tonsellito decision the Court must have known that the father would have recovered in the first action all that he might have recovered in the second action. the Georgia Court in Lundsford could not have used that reasoning. the husband were to sue the railroad and collect damages those damages would not include the damages to the wife occasioned by her loss of consortium. That is to say, the wife of an injured employee has an independent right to recover for damages for loss



of consortium. Accordingly if the wife were to sue for her loss of consortium although her husband might recover under FELA for his injury, there would be no danger of double recovery . The Winfield decisions, upon which the Georgia Court in Lunsford and the United States Supreme Court in Tonsellito really say nothing more than that persons having a right to sue under FELA must recover from the railroad by means of remedies given them by FELA and cannot recover under State FELA does not give the wife of an injured employee the right to sue for her separate loss of consortium. But the Lunsford decision goes so far as to use unnecessary language that a person who has an independent right to sue which arises out of the injury to an employee may not recovery under FELA, may not recover under State law, may not recover at all. Lunsford decision is further weakened by the fact that the Georgia Supreme Court had a history of uncertainty regarding whether a wife could sue for loss of consortium.

In 1950, in the case of <u>Hitaffer vs. Argonne</u>

Co. 87 App. D.C. 57, 183 F2nd, 23 ALR 2nd 1366 (1950)

the question was directly presented to the Court. The

Wife was permitted to bring an action for loss of

consortium <u>even though</u> her husband was injured and

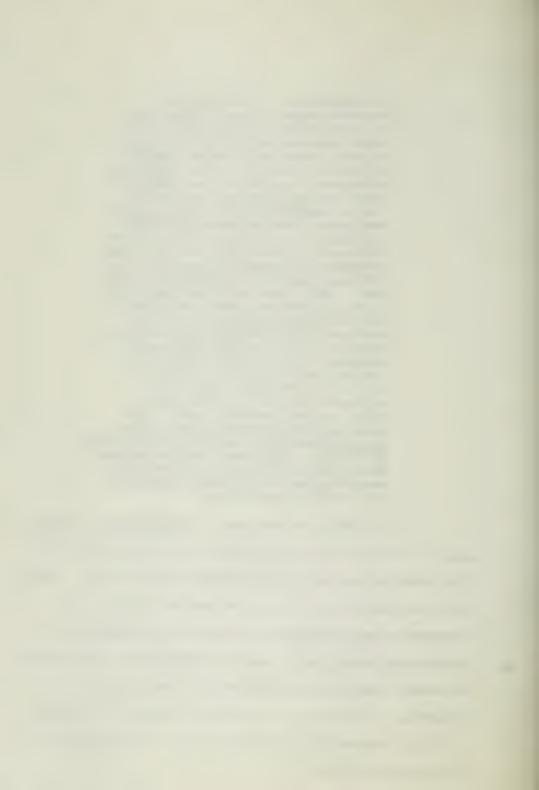
previously permitted to make recovery under the Federal

Workman's Compensation Statute for the District of

Columbia, 33 USCA Sec. 907, 908; It should be pointed

out that Section 905 of the Workmen's Compensation Act

provided as follows:



"The liability of an employer prescribed in Section 904 of this Chapter shall be exclusive and in place of all other liability of such employer to the employee, his legal representative, husband, or wife, parents, dependents, next of kin, and anyone otherwise entitled to recover damages from such employer at law or in admiralty on account of such injury or death..." (emphasis added.)

At page 1376 of 23 ALR 2d the Court said:

"There can be no doubt but that this section (meaning the Workmen's Compensation Act, Section 905) is designed to make the employer's liability under this statute exclusive of any other liability either at law ... to the injured employee, or anyone suing in the employee's right. But where a third person is suing in his or her own right, on account of the breach of some independent duty owed them by the employer, even though the operative facts out of which this independent right ... arose are the same as those out of which the injured employee recovers under the Act, the Act does not proscribe the third person's cause of action. (emphasis added.)

At page 1377 of 23 ALR 2d the Court says:

"There can be no doubt, therefore, that injury to the consortium
is an injury to a right which is
independent of any right in the
other spouse and to which the
defendant owes an independent duty,
and in view of the fact that this
appellant is suing in her own right
for the breach of an independent duty
owing her, we cannot see that the Act



(meaning the Federal Workmen's Compensation Act) was designed to deprive her of her action.

"Moreover, it would be contrary to reason to hold that this Act cuts off independent rights of third persons when the whole structure demonstrates that it is designed to compensate injured employees or persons suing in the employee's right on account of employment connected disability or death. It can hardly be said that it was intended to deprive third persons of independent causes of action where the Acts does not even purport to compensate them for any Loss. A brief examination of it will reveal that there is no provision therein for compensating a spouse for the loss of consortium. (It must be noted here that there is no provision in F.E.L.A. for compensating a spouse for the loss of consortium). As we have already pointed out, no distinction is made as between the amount of compensation payable to married and unmarried injured male claimants, despite the fact that the latter was under a legal duty tosupport the wife, and any impairment of the ability to perform that duty is a compensable element of damages, belonging to the wife where the husband has failed to recover therefor." (Emphasis added.)

The <u>Hitaffer</u> decision was over-ruled by <u>Smither & Co. vs. Coles</u> 242 F2d 220 (U. S. Court of Appeals - D. C. - 1957).

It is the opinion of the writer however, that the decision as rendered in the Duffy case, supra, is well reasoned and is far better taken than the Smithers case and we quote at page 74 thereof:



"Finally, defendants point out that where this question (the question whether a wife has an action for loss of consortium inflicted by defendant's negligent act) has been presented in other jurisdictions, the overwhelming weight of authority is against permitting this action, and this is true. However, the trend of authorities is in the other direction. As pointed out in Hitaffer ... only one case was found prior to that decision which permitted the action, and that case had been overruled. However, in the 112 years since the Hitaffer decision permitting the action was rendered, (a number of jurisdictions have recognized the right of the wife to maintain such action) ...

"***All of the grounds advanced by the various Courts for refusing to permit the action are taken up. discussed and demolished as being completely unreasonable and illogical in the opinion of Hitaffer vs. Argonne Co., supra. "(emphasis added

It will be remembered that one of the grounds advanced in <u>Hitaffer</u> for denying the wife the right to sue was the fact that there was a Workmen's Compensation Act under which the husband could recover.

If the Tonsellito decision and the Lundsford decision, upon which it relies means that an
injured employee may sue under the F.E.L.A. but that
his wife may not exercise her independent right to
sue for loss of consortium under Montana Law, then



we submit that the decisions violate a basic principal of the Federal System.

In 16 Am Jur 2d at page 445:

"A State law is superceded by a Congressional law only to such an extent as the two are inconsistent. An Act of Congress may occupy only a limited portion of the field of regulation of a particular subject matter, leaving unimpaired the right of the several states to enact regulations covering other aspects of the subject or merely to supplement the Federal Legislation in respect to local conditions. As respects Federal legislation of limited scope, it has been said that in determining whether a State regulation has been pre-empted by Federal action, the intent to supercede the exercise by the State of its police power as to matters not covered by the Federal legislation is not to be inferred from the mere fact that Congress has seen fit to circumscribe its regulations and to occupy a limited field; such an intent on the part of Congress, fairly interpreted, in actual conflict with the law of the State."

In 16 Am Jur 2d, page 466, with supporting citations, it is written:

"...it will not be held that a Federal Statute was intended to supercede the exercise of the power of the State, unless there is this clear manifestation of intention, since the exercise of Federal supremacy is not lightly to be presumed. The test of whether both Federal and State regulation must give way, is whether both regulations can be enforced without



impairing the Federal superintendents of the field, not whether they are aimed at the same or different objectives."

Plaintiff contends that to allow her to bring an action for loss of consortium under Montana law does not interfere with the Federal legislation commonly referred to as F.E.L.A.. inthat there is no provision in F.E.L.A. by which the wife can recover for loss of consortium.

V: CONCLUSION

We respectfully submit, in conclusion, as follows:

That there is no method or means provided in the F.E.L.A. whereby the plaintiff might recover under that act for the wife is given no right therein to sue for damages when her husband had merely been injured. There is no section of that act that states that it is to be exclusive remedy for any person who might have suffered a damage to their rights because an employee was injured. Nevertheless, we submit the lower Court has come to that conclusion by reasoning that the wife cannot sue for an injury to an independent right if the injury arose out of the "same transaction" in which the husband received his injury and further. if the husband could sue for those injuries under the F.E.L.A. Thus, the lower Court denies the plaintiff's right to sue for loss of consortium



under the Montana law, merely because the plaintiff's husband could sue under the F.E.L.A. The lower Court then permits the husband, by virtue of his actions, to destroy an existing legal right invested in the plaintiff.

The conclusion drawn by the defendant violates several basic thoughts:

- (1) One injured by the negligent act of another should be allowed compensation for her suffering;
- (2) F.E.L.A. was written so that injured employees of interstate railroads would be able to recover damages and the defendant's conclusion that the wife cannot sue is inconsistent with F.E.L.A.'s broad humane purpose;
- (3) When there is a question
 whether a Federal Act overrides a State law, the State
 law is not to be set aside unless there is an obvious
 repugnancy or the Congress
 clearly manifested its intention



Mexico Board of Examiners. 374 U.S. 424, 10L.ed 2d 983, 83 S.Ct. 1759; Kelly vs. Washington, 302 U.S. 1, 82 L.Ad 3, 58 S.Ct. 87; California vs. Zook 336 U.S. 725, 93 L.ed 1005, 69 S.Ct. 841.

2. The F.E.L.A. has no place in the discussion of the instant case. The rights of the plaintiff are based upon and secured by the laws of the State of Montana; such rights have not been, nor should they be destroyed by the enactment of a Federal Statute.

Respectfully submitted,
TIPP, HOVEN, & BRAULT and
GORDON E. HOVEN

By
Attorneys for Plaintiff
and Appellant
123 West Broadway
Missoula, Montana



CERTIFICATE

The undersigned counsel for the appellant certify the provisions of Rules 18 and 19 of the U. S. Court of Appeals for the Ninth Circuit have been examined and that in their opinion the forgoing brief conforms to all requirements of those rules.

VERNON HOVEN

Service of three (3) copies of the appellant's brief acknowledged this ____ day of October, 1967.

Weir, Gough & Booth Cordell Johnson 301 First National Bank Bldg. Helena, Montana



No 22/27

IN THE

United States Court of Appeals

For the Ninth Circuit

ELEANORE R. JESS,

Appellant,

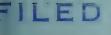
vs.

GREAT NORTHERN RAILWAY COMPANY, corporation,

Appellee.

Brief of Appellee

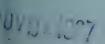
On Appeal from the United States District Court for the District of Montana



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WEIR, GOUGH & BOOTH CORDELL JOHNSON 301 First National Bank Building Helena, Montana 59601 Attorneys for Appellee

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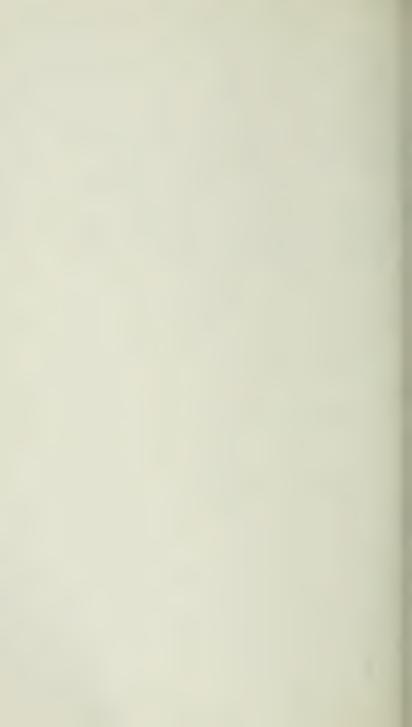




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No. 22127

IN THE

United States Court of Appeals

For the Ninth Circuit

ELEANORE R. JESS,

Appellant,

vs.

GREAT NORTHERN RAILWAY COMPANY, a corporation,

Appellee.

Brief of Appellee

On Appeal from the United States District Court for the District of Montana

STATEMENT OF JURISDICTION

This is an appeal from a judgment dismissing a complaint pursuant to appellee's Motion to Dismiss. The case was originally filed in the State Court in Montana and was removed to the United States District Court for the District of Montana. The United States District Court had jurisdiction under 28 U.S.C. §1332(a)(1).

This Court has jurisdiction of the appeal as provided for in 28 U.S.C. §1291.

STATEMENT OF THE CASE

In addition to the matter contained under the heading "Statement of the Case", on pages 1 and 2 of Appellant's brief, the complaint which was filed by Appellant in this case sought to recover damages in the amount of \$125,000.00 for loss of future earnings of her husband. Throughout the proceedings on Appellee's Motion to Dismiss in the District Court, Appellant treated this case as an action for loss of consortium, but the prayer of the complaint includes not only a count of \$50,000.00, for damages for loss of consortium but also a count in the aforementioned amount of \$125,000.00, for Appellant's husband's loss of future earnings.

ARGUMENT

Summary of Argument

I. THE FEDERAL EMPLOYERS' LIABILITY ACT (45 U.S.C. §§51 et seq.) PROVIDES THE EXCLUSIVE REMEDY AVAILABLE FOR RECOVERY OF DAMAGES FOR INJURIES SUSTAINED BY RAILROAD EMPLOYEES IN THE COURSE OF THEIR EMPLOYMENT.

II. UNDER THE FEDERAL EMPLOYERS' LIABILITY ACT (45 U.S.C. §§51 et seq.), THE SPOUSE OF AN INJURED RAILROAD EMPLOYEE MAY NOT MAINTAIN AN ACTION FOR LOSS OF CONSORTIUM OR FOR LOSS OF THE INJURED EMPLOYEE'S FUTURE WAGES.

I.

The complaint filed by appellant in this case alleges that appellant's husband was an employee of appellee, Great Northern Railway Company; and on January 12, 1965, while engaged in his employment, he sustained injury as a result of negligence on the part of appellee Railway Company. The complaint then asks for damages in the amount of \$125,000.00, for loss of future wages of appellant's husband; and the amount of \$50,000.00, for appellant's loss of consortium.

Section 1 of the Federal Employers' Liability Act, (45 U.S.C. §51) reads as follows:

"§51. Liability of common carriers by railroad, in interstate or foreign commerce, for injuries to employees from negligence; definition of employees.

Every common carrier by railroad while engaging in commerce between any of the several States or Territories, or between any of the States and Territories, or between the District of Co-

lumbia and any of the States or Territories, or between the District of Columbia or any of the States or Territories and any foreign nation or nations, shall be liable in damages to any such person suffering injury while he is employed by such carrier in such commerce, or, in case of the death of such employee, to his or her personal representative, for the benefit of the surviving widow or husband and children of such employee; and, if none, then of such employee's parents; and, if none, then of the next of kin dependent upon such employee, for such injury or death resulting in whole or in part from the negligence of any of the officers, agents, or employees of such carrier, or by reason of any defect or insufficiency, due to its negligence, in its cars. engines, appliances, machinery, track, roadbed, works, boats, wharves, or other equipment.

Any employee of a carrier, any part of whose duties as such employee shall be the furtherance of interstate or foreign commerce or shall, in any way directly or closely and substantially, affect such commerce as above set forth shall, for the purposes of this chapter, be considered as being employed by such carrier, in such commerce and shall be considered as entitled to the benefits of this chapter. Apr. 22, 1908, c. 149, §1, 35 Stat. 65; Aug. 11, 1939, c. 685, §1, 53 Stat. 1404."

The complaint filed in this case does not specifically allege that the action is under the Federal Employers' Liability Act, or F.E.L.A. as it is commonly referred to, but, nevertheless, the allegations contained

in the complaint do show that the injury complained of is one which is covered by the F.E.L.A.

The Federal Employers' Liability Act is the exclusive remedy available for injuries such as the injuries complained of in the complaint filed in this case. The F.E.L.A. does not give the wife of an injured employee (unless the injury results in death which is not the situation in this case) any standing to bring the action. And, in death cases, the action can be brought only by the personal representative of the deceased and not the surviving spouse, as such. Loss of consortium is not an element of damages recoverable under the Federal Employers' Liability Act. The complaint in this case does not state a claim against defendant upon which relief can be granted and the District Court was correct in granting appellee's Motion to Dismiss the complaint.

The United States Supreme Court ruled that the Federal Employers' Liability Act is the exclusive remedy in cases involving injuries to railway employees in the so-called "Second Employers' Liability Cases" (Mondou v. New York, New Haven and Hartford Railroad Co., 233 U.S. 1, 55, 56 L.Ed. 327, 348, 38 L.R.A. (N.S.) 44, 32 S.Ct. 169, 1 NCCA 875). These four cases were consolidated for hearing and decision by the Supreme Court and the principal point involved was whether or not the F.E.L.A. was consti-

tutional. The Court held that it was. The Court also said, at 56 L.Ed. 348:

"True, prior to the present act, the laws of the several states were regarded as determinative of the liability of employers engaged in interstate commerce for injuries received by their employees while engaged in such commerce. But that was because Congress, although empowered to regulate that subject, had not acted thereon. and because the subject is one which falls within the police power of the states in the absence of action by Congress. Sherlock v. Alling, 93 U.S. 99, 23 L.Ed. 819; Smith v. Alabama, 124 U.S. 465, 473, 480, 482, 31 L.Ed. 508, 510, 513, 514, 1 Inters.Com.Rep. 804, 8 Sup.Ct.Rep. 564; Nashville, C. & St. L.R. Co. v. Alabama, 128 U.S. 96, 99, 32 L.Ed. 352, 2 Inters.Com.Rep. 238, 9 Sup. Ct.Rep. 28; Reid v. Colorado, 187 U.S. 137, 146, 47 L.Ed. 108, 113, 23 Sup. Ct.Rep. 92, 12 Am. Crim.Rep. 506. The inaction of Congress, however, in no wise affected its power over the subject. The Lottawanna (Rodd v. Heartt) 21 Wall. 558, 581, 22 L.Ed. 654, 664; Gloucester Ferry Co. v. Pennsylvania, 114 U.S. 196, 215, 29 L.Ed. 158, 166, 1 Inters.Com.Rep. 382, 5 Sup.Ct.Rep. 826. And now that Congress has acted, the laws of the states, in so far as they cover the same field, are superseded, for necessarily that which is not supreme must yield to that which is. Gulf, C. & S. F. R. Co. v. Hefley, 158 U.S. 98, 104, 39 L.Ed. 910, 912, 14 Sup.Ct.Rep. 802 Southern R. Co. v. Reid, No. 487, 222 U.S. 424, ante, 257, 32 Sup.Ct.Rep. 140; Northern P. R. Co. v. Washington, No. 136, 222 U.S. 370, ante, 237, 32 Sup. Ct.Rep. 160." (Emphasis supplied.)

In 1917 the Supreme Court of the United States decided some cases which had to do with the scope of the F.E.L.A. as it applied to situations which some people felt might also have been covered by State workmen's compensation acts. In New York Central Railroad Co. v. Winfield, 244 U. S. 147, 149, 150, 37 S.Ct. 546, 61 L.Ed. 1045, L.R.A. 1918C, 439, Ann. Cas. 1917D, 1139, the Court said:

"That the act is comprehensive and also exclusive is distinctly recognized in repeated decisions of this court. Thus, in Missouri, K. & T. R. Co. v. Wulf, 226 U.S. 570, 576, 57 L.Ed. 355, 363, 33 Sup.Ct.Rep. 135, Ann.Cas. 1914B, 134, and other cases, it is pointed out that the subject which the act covers is 'the responsibility of interstate carriers by railroad to their employees injured in such commerce;' in Michigan C. R. Co. v. Vreeland, 227 U.S. 59, 66, 67, 57 L.Ed. 417, 419, 420, 33 Sup.Ct.Rep. 192, Ann.Cas. 1914C, 176, it is said that 'we may not piece out this act of Congress by resorting to the local statutes of the state of procedure or that of the injury;' that by it 'Congress has undertaken to cover the subject of the liability of railroad companies to their employees injured while engaged in interstate commerce,' and that it is 'paramount and exclusive; in North Carolina R. Co. v. Zachery, 232 U.S. 248, 256, 58 L.Ed. 591, 594, 34 Sup.Ct. Rep. 305, Ann. Cas. 1914C, 159, 9 N.C.C.A. 109,

it is held that where it appears that the injury occurred while the carrier was engaged and the employee employed in interstate commerce, the federal act governs to the exclusion of the state law; . . ."

See also: St. Louis, San Francisco, and Texas Railway Company v. Seale et al., 229 U.S. 156, 158, 57 L.Ed. 1129, 1133, 33 S.Ct. 651; North Carolina Railroad Co. v. James A. Zachery, Administrator, 232 U.S. 248, 256, 345 S.Ct. 305, 58 L.Ed. 591, Ann.Cas. 1914C, 159; Erie Railroad Company v. Winfield, 244 U.S. 170, 37 S.Ct. 556, 61 L.Ed. 1057; Camerlin v. New York Central Railroad Company, 199 F.2d 698, 703, (CA1-1952).

The complaint in this case does not allege that the Federal Employers' Liability Act is applicable. However, since the F.E.L.A., when applicable, is the exclusive remedy against a railroad company for injuries suffered by railroad employees, disregard of the F.E.L.A. by the parties does not relieve the Court of the necessity of determining whether the F.E.L.A. applies. Metropolitan Coal Co. v. Johnson, New York, New Haven and Hartford Railroad Co. v. Johnson, 265 F.2d 173, 177 (CA1-1959). The allegations in the complaint filed in this case are sufficient to show that the accident occurred while plaintiff's husband was employed by an interstate railway company. The F.E.L.A. is the exclusive remedy for damages suf-

fered by reason of the injury alleged in the complaint.

In Florida East Coast Railway Company v. Pollack, 154 S.2d 346 (Fla-1963) the District Court of Appeal, Third District of Florida, said:

"The Federal Employers' Liability Act exclusively covers the entire field under which an employer in interstate commerce shall be liable for injury to its employee likewise engaged. The substantive rights and obligations of one bringing an action under the act depend upon the act and applicable principles of common law as interpreted and applied by the federal courts. Chesapeake & Ohio R. Co. v. Stapleton, 279 U.S. 587, 49 S.Ct. 442, 73 I.Ed. 861; Chicago, N. & St.P.R. Co. v. Coogan, 271 U.S. 472, 46 S.Ct. 564, 70 L. Ed. 1041; New Orleans & N.E.R. Co. v. Harris, 247 U.S. 367, 38 S.Ct. 535, 62 L.Ed. 1167. No state statute, law or other enactment can enlarge or contract the operation of the act and the rights and obligations arising thereunder. Chesapeake & Ohio R. Co. v. Stapleton, supra. See also Davee v. Southern Pacific R. Co., 58 Cal.2d 572, 25 Cal. Rptr. 445 (1962), 375 P.2d 293."

In a recent case decided by the U. S. Court of Appeals for the Sixth Circuit, *Bridger v. Union Railway Company*, 355 F.2d 382 (1966), the Court said, at 355 F.2d 382, 393:

"Courts of the land have long, often, and firmly held that since Congress, by the adoption of the Federal Employers' Liability Act, has preempted the 'field of employers' liability to em-

ployees in interstate transportation by rail * * * all state laws upon that subject were superseded * * * the rights and obligations of the [railroad employer] depend upon that Act and applicable principles of common law as interpreted by the federal courts.' Chesapeake & Ohio R.R. v. Stapleton, 279 U.S. 587, 588, 49 S.Ct. 442, 73 L.Ed. 861 (1929)."

Appellant, as page 7 of her brief, argues that the complaint filed in this case is for a personal and separate claim that appellant has for damages alleged to have been caused by the negligence of appellee railroad when appellant's husband was engaged in the scope of his employment as an employee of appellee. Appellant's contention cannot stand in light of the clearly established rule that the Federal Employers' Liability Act is the exclusive remedy for injuries such as the injuries complained of in this case.

The principal difference between the positions taken by appellant and appellee in this case is that appellant contends that the Federal Employers' Liability Act has nothing to do with this case and appellee, on the other hand, submits that the case does fall within the purview of the Federal Employers' Liability Act and is to be decided by referring to the Act and the cases which have interpreted it.

On page 14 of appellant's brief appellant cites the last paragraph of 16 Am.Jur.2d, Constitutional Law,

§207, page 445. The immediately preceding two paragraphs of Section 207, beginning at 16 Am.Jur.2d, p. 444, read as follows:

"It is relatively obvious that where Congress has legislated upon a subject which is within its constitutional control and over which it has the right to assume exclusive jurisdiction and has manifested its intention to deal therewith in full. the authority of the states is necessarily excluded, and any state legislation on the subject is void. The relative importance to the state of its own law is not material when there is a conflict with a valid federal law; any state law, however clearly within a state's acknowledged power, which interferes with or is contrary to federal law must yield. Moreover, the state has no right to interfere or, by way of complement to the legislation of Congress, to prescribe additional regulations and what they deem auxiliary provisions for the same purpose. Congress' authority to act within the scope of its powers so as to displace state power is no less when the state power which it displaces would otherwise have been exercised by the state judiciary rather than by the state legislature.

Perhaps less obvious, but no less well established, is the rule that when Congress passes a law in that field of legislation common to both federal and state governments, the act of Congress supersedes all inconsistent state legislation. Congress in regulating a matter within the concurrent field of legislation speaks for all the

people and all the states, and it is immaterial that the public policy embodied in the congressional legislation overrules the policies theretofore adopted by any of the states with respect to the subject matter of such legislation."

Appellant cites a portion of 16 Am.Jur. 2d, *Constitutional Law*, Section 208, on Page 14 of her brief. The citation erroneously refers to being on Page 466. This is apparently a typographical error, as the quotation does appear at 16 Am. Jur. 2d, *Constitutional Law*, §208, p. 446. The entire first paragraph of Section 208 reads as follows; as set forth in 16 Am.Jur. 2d, p. 445-446:

"Determination of existence of conflict with state action.

Basic to the ascertainment of the effect of the enactment of federal legislation upon state legislation within the same legislative area is the question whether there is actually a conflict between the federal and state legislation. When the question is whether the federal act overrides a state law, the entire scheme of the statute must be considered, and a state law enacted under any of the reserved powers—especially if under the police power—is not to be set aside as inconsistent with an act of Congress, unless there is actual repugnancy or Congress has at least manifested a purpose to exercise its paramount authority over the subject. Absent an obvious repugnancy between the federal and state legislation, a state will be held barred, as a conse-

quence of federal legislation, from legislating within a particular area only where the intention of Congress to exclude state action is clearly manifested. The question whether Congress and its commissions acting under it have so far exercised the exclusive jurisdiction that belongs to it as to exclude a state must be answered by a judgment upon the particular case; it will not be held that a federal statute was intended to supersede the exercise of the power of the state, unless there is this clear manifestation of intention. since the exercise of federal supremacy is not lightly to be presumed. The test of whether both federal and state regulations may operate, or the state regulation must give way, is whether both regulations can be enforced without impairing the federal superintendence of the field, not whether they are aimed at similar or different obiectives."

The rule that the Federal Employers' Liability Act is the exclusive remedy available for the recovery of damages for injuries sustained by railway employees was firmly established by two decisions of the Supreme Court of the United States which were handed down on the same day, May 21, 1917. The cases are: New York Central Railroad Company v. James Winfield, 244 U.S. 147, 61 L.Ed. 1045; and Erie Railroad Company v. Amy L. Winfield, 244 U.S. 170, 61 L.Ed. 1057. In the James Winfield case, plaintiff sustained an injury in which he lost the sight of one eye and he filed a claim under the Workmen's Compensation

Law of New York and an award was made to him. The railroad company appealed the award, taking the position that the obligation of the railroad company was governed exclusively by the Federal Employers' Liability Act. The Supreme Court of the United States reversed the New York Workmen's Compensation Commission, holding that the Federal Employers' Liability Act is comprehensive and exclusive in cases involving injuries to railway employees. The Court said:

"It is settled that under the commerce clause of the Constitution Congress may regulate the obligation of common carriers and the rights of their employees arising out of injuries sustained by the latter where both are engaged in interstate commerce; and it also is settled that when Congress acts upon the subject all state laws covering the same field are necessarily superseded by reason of the supremacy of the national authority. Congress acted upon the subject in passing the Employers' Liability Act, and the extent to which that act covers the field is the point in controversy. By one side it is said that the act, although regulating the liability or obligation of the carrier and the right of the employee where the injury results in whole or in part from negligence attributable to the carrier. does not cover injuries occurring without such negligence, and therefore leaves that class of injuries to be dealt with by state laws; and by the other side it is said that the act covers both classes of injuries and is exclusive as to both. The state decisions upon the point are conflicting. The New York court in the present case and the New Jersey court in Winfield v. Erie R. C. 88 N.J.L. 619, 96 Atl. 394, hold that the act relates only to injuries resulting from negligence, while the California court in Smith v. Industrial Acci. Commission, 26 Cal. App. 560, 147 Pac. 600, and the Illinois court in Staley v. Illinois C. R. Co. 268 Ill. 356, L.R.A. 1916A, 450, 109 N.E. 342, hold that it has a broader scope and makes negligence a test,—not of the applicability of the act, but of the carrier's duty or obligation to respond pecuniarily for the injury.

In our opinion the latter view is right and the other wrong. Whether and in what circumstances railroad companies engaging in interstate commerce shall be required to compensate their employees in such commerce for injuries sustained therein are matters in which the nation as a whole is interested, and there are weighty considerations why the controlling law should be uniform and not change at every state line. Baltimore & O. R. Co. v. Baugh, 149 U.S. 368, 378, 379, 37 L.Ed. 772, 777, 778, 13 Sup.Ct.Rep. 914. It was largely in recognition of this that the Employers' Liability Act was enacted by Congress. Second Employers' Liability Cases (Mondou v. New York, N. H. & H. R. Co.) 223 U.S. 1, 51, 56 L.Ed. 327, 346, 38 L.R.A. (N.S.) 44, 32 Sup. Ct.Rep. 169, 1 N.C.C.A. 875. * *

In the *Amy Winfield* case the widow of a railroad employee who had been killed while walking across the

tracks at the end of a day's work, sought compensation under the New Jersey Workmen's Compensation Law. The highest appellate court in New Jersey held that the Federal Employers' Liability Act did not apply to the case because the Act did not and does not impose liability on the rail carrier in the absence of causal negligence. The Supreme Court of the United States reversed the New Jersey Court, holding that the Federal Employers' Liability Act did apply. The Court said:

"The first question is fully considered in New York C. R. Co. v. Winfield, the opinion in which has been just been announced, 244 U.S. 147, ante, 1045, 27 Sup.Ct.Rep. 546, and it suffices here to say that, for the reasons there given, we are of opinion that the Federal Act proceeds upon the principle which regards negligence as the basis of the duty to make compensation, and excludes the existence of such a duty in the absence of negligence, and that Congress intended the act to be as comprehensive of those instances in which it excludes liability as of those in which liability is imposed. It establishes a rule of regulation which is intended to operate uniformly in all the states, as respects interstate commerce, and in that field it is both paramount and exclusive."

The injuries alleged in the complaint filed by appellant in this case were sustained by appellant's husband who was engaged in the course and scope of his

employment as an employee of appellee railroad. The exclusive remedy for the recovery of damages for such injuries is provided for in the Federal Employers' Liability Act (45 U.S.C. §§51 et seq.). The Federal Employers' Liability Act does not provide for the recovery of damages for loss of consortium by a spouse of an injured railway worker. Nor does the Act make provision for the spouse of an injured railway worker to maintain an action for the injured railway employee's loss of future wages.

The complaint filed by appellant in this case clearly does not state a claim against appellee upon which relief can be granted. The Order granting appellee's Motion to Dismiss the complaint should be sustained.

II.

The complaint in this case asks for damages for loss of consortium suffered by appellant by reason of the fact that her husband was injured while engaged in his employment, due to the alleged negligence of appellee railroad. The Federal Employers' Liability Act is the exclusive, paramount and only law which provides for recovery of damages in cases of injuries involving railway employees and it does not include, as an element of damages, loss of consortium.

Companion cases were argued in the United States Supreme Court in 1917 which are persuasive for appellee railroad in this case. The cases, *New York*

Central and Hudson River Railroad Co. v. Michael Tonsellito, an infant; and New York Central and Hudson River Rialroad Co. v. James Tonsellito, 244 U.S. 360, 61 L.Ed. 1194, involved a situation where a 17 year old youngster named Michael Tonsellito suffered injuries while engaged in the course of his employment by the defendant railroad company. Michael Tonsellito brought an action through his father, James Tonsellito, as next friend, under the Federal Employers' Liability Act. The father brought the companion suit and claimed damages for expenses incurred for medical attention to Michael Tonsellito and he also claimed damages for the loss of Michael Tonsellito's services. Judgments for the plaintiffs were affirmed by the highest appellate court of New Jersey. The judgment for the injured worker was affirmed by the United States Supreme Court; but the judgment for the father for the expenses for the son's medical treatment and for the loss of his son's services was reversed. The Court said:

"The court of errors and appeals ruled, and it is now maintained, that the right of action asserted by the father existed at common law and was not taken away by the Federal Employers' Liability Act. But the contrary view, we think, is clearly settled by our recent opinions, in New York C.R. Co. v. Winfield, 244 U.S. 147, ante, 1045, 37 Sup.Ct.Rep. 546, and Erie R. Co. v. Winfield, 244 U.S. 170, ante, 1957, 37 Sup.Ct.

Rep. 556 (decided May 21, 1917). There we held the act 'is comprehensive and also exclusive' in respect of a railroad's liability for injuries suffered by its employees while engaging in interstate commerce. 'It establishes a rule or regulation which is intended to operate uniformly in all the states as respects interstate commerce, and in that field it is both paramount and exclusive.' Congress having declared when, how far, and to whom carriers shall be liable on account of accidents in the specified class, such liability can neither be extended nor abridged by common or statutory laws of the state."

In Louisville and Nashville Railroad Co. et al. v. unsford, 216 Ga. 289, 116 S.E.2d 232 (Ga.-1960), as Supreme Court of Georgia said:

"This case came to the Supreme Court in certiorari to the Court of Appeals. The trial judge had dismissed the plaintiff's petition on a general demurrer, which questioned its sufficiency to state a cause of action for damages flowing from an alleged loss of the right of consortium. The Court of Appeals reversed that ruling. See Lunsford v. Louisville & Nashville Railroad Co., 101 Ga.App. 374, 114 S.E.2d 310. Hence the only question which is presented to this court for decision is whether a wife may sue for loss of consortium occasioned by an injury which her husband, an interstate employee of a railroad company, sustained in consequence of his emplover's negligence as against the defendant's contention that Congress, in passing the Federal

Employers' Liability Act, 45 U.S.C.A. §51 et seq. preempted that field of legislation and excluded all remedies which might be resorted to for injuries to employees other than those provided for by such act. In determining the question so presented, it has been settled law in this State for a long time that this court and the court of appeals are both bound by and must follow the decisions of the Supreme Court of the United States construing applicable Federal statutes. See Clews v. Munford, 78 Ga. 476, 3 S.E. 267; Lee v. Central of Genrgia Ry. Co., 147 Ga. 428, 430, 93 S.E. 558, 13 A.L.R. 156; Looper v. Ga. S. & F. Railway Co., 213 Ga. 279, 99 S.E.2d 101; Southern Ry. Co. v. Turner, 88 Ga.App. 49, 51, 76 S.E. 2d 96; Atlantic Coast Line R. Co. v. Shed, 90 Ga.App. 766, 769, 84 S.E.2d 212. And since the only question presented by the record in this case is settled and controlled adversely to the plaintiff's asserted claim for damages, and her right to maintain an action therefor by the ruling of the Supreme Court of the United States in New York Central & Hudson River Railroad Co. v. Tonsellito, 244 U.S. 360, 361, 37 S.Ct. 620. 61 L.Ed. 1194; New York Central R. Co. v. Winfield, 244 U.S. 147, 37 S.Ct. 546; 61 L.Ed. 1045; and Erie Railroad Co. v. Winfield, 244 U. S. 170, 37 S.Ct. 556, 61 L.Ed. 1057, it necessarily follows that the judgment rendered by the Court of Appeals is erroneous, and since those three cases so clearly announce the rule which must be applied in this case, it is not deemed necessary to here restate or elaborate the rulings there made

Judgment reversed. All the Justices concur." In Kinney v. Southern Pacific Co., 375 P.2d 418, Ore.-1962) the Oregon Supreme Court held that a rife, whose husband had recovered under the F.E.L.A. or injuries sustained while employed by the rail carier could not maintain an action for loss of consortum. The Court said:

"In New York Central R.R. Co. v. Winfield, 244 U.S. 147, 37 S.Ct. 546, 61 L.Ed. 1045, it is clearly pointed out that the congress in enacting the Federal Employers' Liability Act, 45 U.S.C.A. §51 et seq., had preempted this field as to carriers engaged in interstate commerce; that this congressional action thus determined that injuries received by such carrier employees are to be compensated under the Act and liability of employers to their employees is to be determined exclusively under the Act, and therefore the states have no power to afford other relief which may create a liability upon the employer.

In New York Cent. & H. H. Co. v. Tonsellito, 244 U.S. 360, 37 S.Ct. 620, 61 L.Ed. 1194, the court reaffirmed these principles set forth in New York Central R. R. v. Winfield, supra, in an action brought by a father to recover for the loss of his minor son's services due to an injury received by the son who had recovered compensation under the Federal Employers' Liability Act, stating, 'Congress having declared when, how far, and to whom carriers shall be liable on account of accidents in the specified class, such liability can neither be extended nor abridged by

common or statutory laws of the state'. (emphasis added)

We are unable to discover any logical reasoning that would permit recovery in an action for loss of constortium by a wife, and not allow a recovery in an action by a parent for loss of a child's services, under this sweeping language of the Supreme Court of the United States. We are bound by these decisions.

The Supreme Court of the State of Georgia in the recent case of Louisville & Nashville Railroad Co. v. Lunsford, 216 Ga. 289, 116 S.E.2d 232, a case in which a wife sought to maintain an action for loss of consortium when the husband had been injured while employed by a carrier and had recovered compensation under the Federal Employers' Liability Act, held as we do, that such an action cannot be maintained."

In the case of *Igneri v. Cie*, *De Transports Oceanques*, 323 F.2d 257 (1963), the Court of Appeals for the Second Circuit held that, under the Jones Act which applies similar rules of law to seaman as the Federal Employers' Liability Act applies to railway employees, a wife has no claim for damages for loss of consortium resulting from injury allegedly caused by negligence of the employer.

The cases cited above clearly establish that a wife of an injured railway employee does not have standing to sue for loss of consortium. Appellant does not cite any case in her brief in which a Court ruled that he wife of an injured railway employee could mainain an action for loss of consortium.

On Page 15 of her brief, appellant argues that she should be allowed to bring an action for loss of consortium under the common law of Montana because to provision in the Federal Employers' Liability Act allows a wife to recover for loss of consortium. Appellee submits that this is precisely why appellant cannot bring such an action. The Federal Employers' Liability Act is exclusive in the field of injuries to railway employees. The Act does not provide for any claims by wives or husbands for loss of consortium and the cases which we have cited above clearly establish that a claim for loss of consortium is not recognized under the Federal Employers' Liability Act in those cases, such as this case, which fall within its purview.

The complaint filed by appellant in the lower court, in addition to claiming loss of consortium, makes a claim for loss of future earnings of appellant's husband. Appellee concedes that the Federal Employers' Liability Act does contemplate, as one of the elements of damage which may be recovered by a successful plaintiff in an F.E.L.A. case, loss of future earnings. However, the right to recover loss of future earnings is vested in the injured employee, or, in the case of the employee's death, the right is vested in his per-

sonal representative. Appellant filed this action as the wife of an injured railway employee. Under the Federal Employers' Liability Act she has no standing to claim loss of his future earnings.

In Sarik et al. v. Pennsylvania Railroad Co., 68 F. Supp. 630 (1946) it was held that a husband of an injured railway employee had no right to recover for injuries to his wife. The Court said:

"When the case was submitted to the jury the court was of opinion that the right of Michael Sarik to recover a verdict depended upon a right at common law. The court so thinking, the jury was erroneously allowed to pass upon his claim. It has been definitely held that the Federal Employers' Liability Act takes away any common law right to recover. It is 'comprehensive and also exclusive', and cannot 'be extended or abridged by common or statutory laws of the state.' See New York Central & Hudson River Railroad Co. v. Tonsellito, 244 U.S. 360, 37 S.Ct. 620, 621, L.Ed. 1104; New York Central Railroad Co. v. Winfield, 244 U.S. 147, 37 S.Ct. 546, 61 L.Ed. 1045; Erie Railroad Co. v. Winfield, 244 U.S. 170, 37 S.Ct. 556, 61 L.Ed. 1057, Ann.Cas. 1918B, 662.

In New York Central & Hudson River Railroad Co. v. Tonsellito, the father of an injured minor employee recovered a verdict in the lower courts for medical expenses paid by him. The Supreme Court reversed this judgment.

Michael Sarik having no right to recover as husband of the injured employee, the motion for a new trial on his behalf is baseless."

The alleged injuries for which damages are sought this case occurred in a factual setting which brings is case within the scope of the Federal Employers' ability Act. The Federal Employers' Liability Act is not allow a spouse of an injured railway worker sue for loss of consortium, nor does the Act allow is spouse to file an action for the injured railway ployee's loss of future earnings. The District art's Order granting appellee's Motion to Dismiss complaint in this case should be sustained.

CONCLUSION

Appellee, Great Northern Railway Company, rectfully submits that the judgment of the District art should be affirmed.

DATED this 17th day of November, 1967.

WEIR, GOUGH & BOOTH CORDELL JOHNSON

By s/ Cordell Johnson

Attorneys for Appellee, Great Northern Railway Company, 301 First National Bank Building Helena, Montana 59601

CERTIFICATE OF COMPLIANCE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

s/ Cordell Johnson Attorney

CERTIFICATE OF SERVICE

I, CORDELL JOHNSON, one of the attorneys for Appellee, Great Northern Railway Company, hereby certify that three copies of the within and foregoing Brief of Appellee were, with postage fully prepaid thereon, mailed on the 17th day of November, 1967, and directed to the following counsel of record:

Tipp, Hoven and Brault and Gordon E. Hoven 123 West Broadway Missoula, Montana 59801

s/ Cordell Johnson

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

INEZ ORTIZ-JIMINEZ,

Appellant

v.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA



JAN 1 6 1968

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Attorneys for Appellee, United States of America



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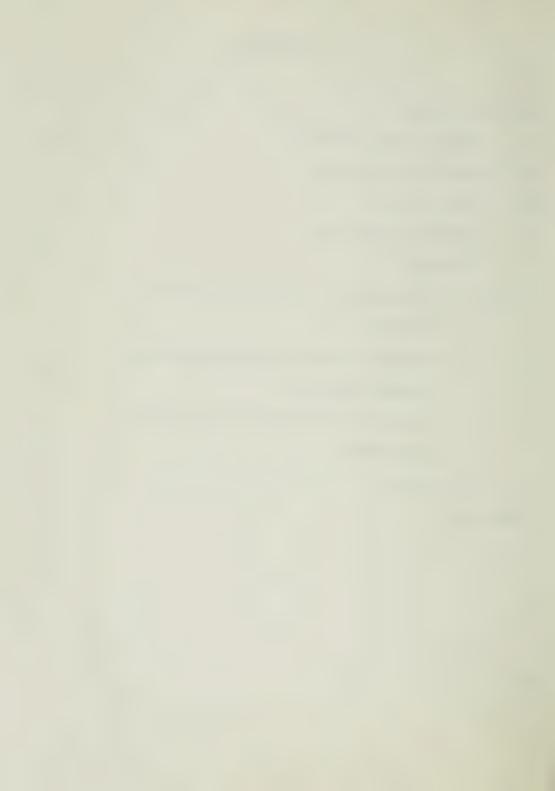


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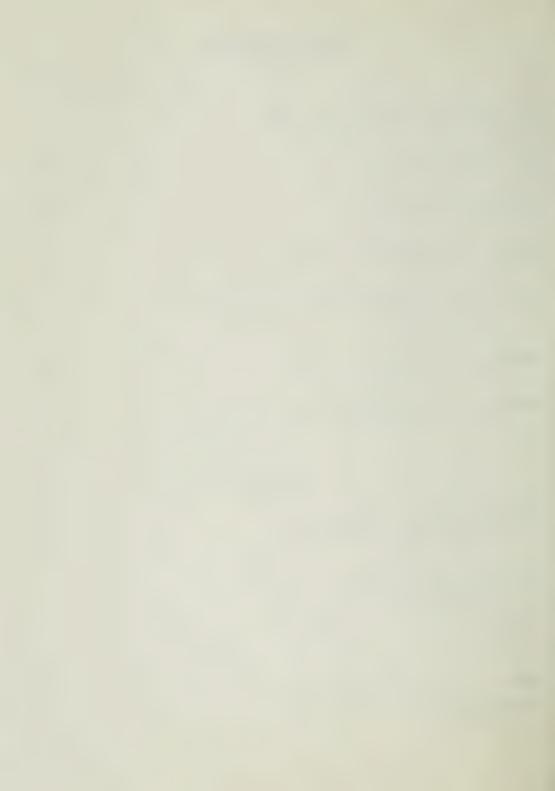
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NO. 22131

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

INEZ ORTIZ-JIMINEZ,

Appellant

v.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

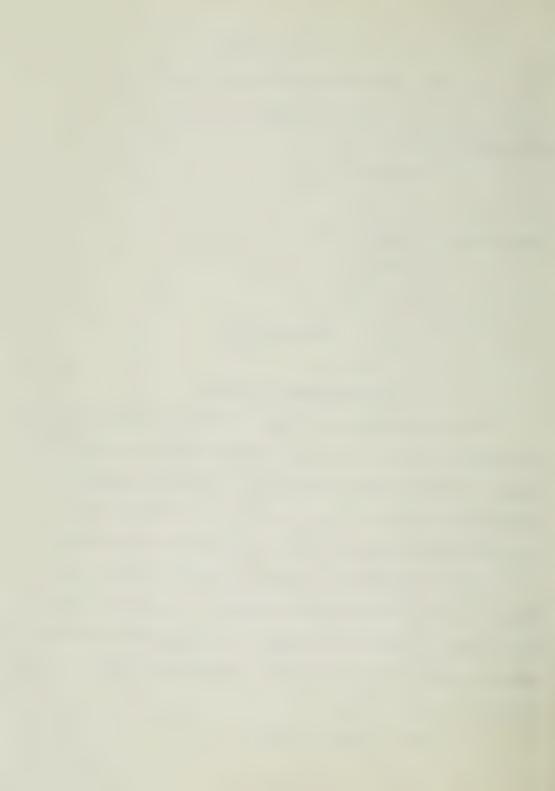
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JURISDICTIONAL STATEMENT

This is an appeal from the judgment of the United States District Court for the Southern District of California, adjudging appellant to be guilty as charged in Counts One, Three, Five and Six of a Six-Count indictment 1/
following trial by the Court. (C.T. 12-14). Judgment of acquittal was granted as to Counts Three and Four as to appellant after the trial ended.

The offenses occurred in the Southern District of California. The District Court had jurisdiction by virtue of Title 18, United States Code, Sections 3231, 1324(a)(2) and 1324(a)(4). Jurisdiction of this Court rests pursuant to Title 28, United States Code, Sections 1291 and 1294.

[&]quot;C.T." refers to Clerk's Transcript.



STATEMENT OF THE CASE

Appellant was charged in each count of a Six Count Indictment returned on March 1, 1967 by the Federal Grand Jury for the Southern District of California, Southern Division, (C.T. 2-7). Counts One, Three and Five alleged, in effect, that on February 5, 1967 appellant in Tijuana, B.C., California, wilfully and knowingly encouraged and induced the entry into the United States at Imperial Beach, California, three different aliens named in each of the said three counts, and said aliens were not lawfully entitled to enter and reside within the United States, and thereafter appellant was first found in the Southern District of California.

Counts, Two, Four and Six alleged, in effect, that on February 5, 1967, within the Southern District of California, appellant transported the same three aliens knowing they were in the United States in violation of the law (C.T. 2-7) and having reasonable grounds to believe their entry into the United States occurred less than three years prior to February 5, 1967.

Appellant waived Jury (C.T. 10) and his trial on all six counts commenced and ended on April 7, 1967 before United States District Judge Raymond E. Plummer. (C.T. 11). Decision was reserved (C.T. 11) (R.T.89).

Thereafter on April 14, 1967 Judge Plummer filed a three-page document entitled "Findings of Fact and General Finding of Guilty", wherein he found appellant guilty as charged in Counts One, Three, Five and Six of the

<sup>2/
&</sup>quot;R.T." refers to Reporter's Transcript.



Indictment, and reaffirmed his order that Judgment of Acquittal be entered as to Counts Two and Four only. (C.T. 12-14).

Thirteen days later, on April 27, 1967, appellant filed a Notice of Motion for a new trial alleging, in substance, insufficient evidence and that appellant should then be allowed to explain his presence at the scene.

Appellant did not allege newly discovered evidence. (C.T. 16-19). The Motion for a new trial was denied on April 28, 1967 and sentence was set for June 5, 1967. (C.T. 20).

On June 5, 1967 appellant was committed to the custody of the Attorney General for 30 days on each of Counts One, Three, Five and Six, to run concurrently making a total sentence of 30 days. (C.T. 21).

A Notice of Appeal was filed the same day, June 5, 1967. (C.T. 22).

III

ERROR SPECIFIED

Errors as alleged by appellant are paraphrased as follows:

- 1. Insufficient evidence.
- Evidence as to a "rented house" should not have been admitted.
- 3. The Court should have granted a judgment of acquittal on grounds of insufficient evidence when appellant didn't testify.



STATEMENT OF THE FACTS

On February 5, 1967, appellant was introduced in the outskirts of Tijuana, Baja, California, Mexico to Roberto Aguirre. (R.T. 61). Mr. Aguirre and four of his companions got in appellant's station wagon and was driven to the beach by appellant. On the way they stopped and picked up the guide (R.T. 62). This was after the other man told appellant they were all ready and everything was ready. Appellant told them to wait for him there. (R.T. 67). He returned with four others. Appellant's wife was with him, but he didn't see the children. (R.T. 63).

Arrangements had been made with another man for appellant to transport them to Los Angeles for \$150.00. (R.T. 67, 70).

Mr. Aguirre thought appellant was the "Coyote." A coyote is "what they call a person who brings persons over here." (R.T. 71). Aguirre and nine others including the guide walked along the beach to where they were arrested. (R.T. 63).

They waded water and their clothes got wet. Appellant told them they were going to change clothes in a house. He didn't recall if the house was in Chula Vista or San Diego. (R.T. 64).

Mr. Albert S. Taylor, Senior Patrol Inspector describes the area along the beach between Chula Vista as a deserted area (R.T. 34) virtually barren country (R.T. 35) and he said all of the aliens were wet to their waists and above. (R.T. 52).



Inspector Taylor and 7 of his subordinates were keeping the "area under surveillance for possible smuggling activity" which they "had prior evidence of." (R.T. 14). They were waiting for the "aliens" to be picked up. (R.T. 15).

Appellant came along driving his own car, a 1958 Cnevrolet Station Wagon. Appellant claimed it was his car and this was further verified by the registration. (R.T. 16). At about 9:00 p.m., appellant drove his car up on the parking lot, (R.T. 17) and backed his car around to the southwest edge of the parking lot (R.T. 19). One of the aliens left the group and came over and talked to Mr. Ortiz, as soon as he backed the car around to where they were hiding down in the breakwater rocks. Five others joined them.

These six persons departed the area. Inspector Taylor stopped the vehicle and took these people into custody and determined they were aliens. (R.T. 20-21). He talked to them in Spanish. They appeared to be of Mexican descent. They had no papers or documents about their persons to indicate legal status in the United States (R.T. 23-24). He asked each alien if they had a legal document or not. (R.T. 55).

The guide-driver claimed to be here illegally also. (R.T. 44-45).

Mr. Taylor said this was a common claim, hoping to be deported as a

"plain wet." (R.T. 53).

Only about three cars were there and a few people were fishing "way out on the pier." (R.T. 39, 56-57).

Mr. Taylor concealed himself in appellant's automobile and had



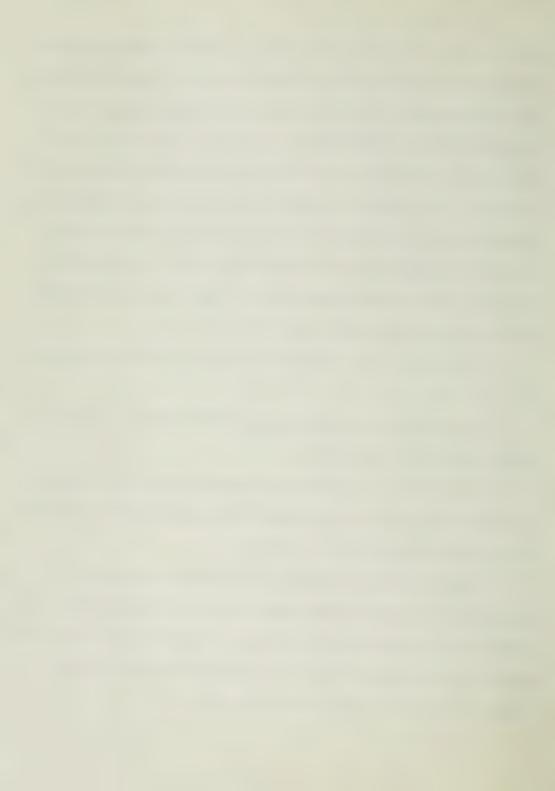
the guide-driver return to the parking lot (R.T. 22). Mr. Taylor ordered the driver to return to the same spot and back-up, as before, where the remaining aliens were hiding (R.T. 24). The driver appeared purposely to go through the middle section and started back. Mr. Taylor "told him to pull over to the spot and he ignored me." At this point, appellant began whistling and "hollaring." At Mr. Taylor's instructions, the guide-driver then approached appellant near a taxicab in which his wife and child were already seated. (R.T. 47-48). Appellant said to the driver "Que paso?", meaning "What's going on?" Appellant could then observe Mr. Taylor, so he identified himself and placed appellant under arrest. (R.T. 49).

The aliens each had \$100 to \$150.00 on their persons and more. (R.T. 57).

Appellant was an "immigrated alien." (R.T. 58). His wife had a border crossing card. (R.T. 57).

Appellant was unemployed and resided in Tijuana. He paid \$50.00 a month for a rented house in San Diego. He had rent receipts on his person, but they were returned to him. (R.T. 29-32).

One of the aliens, Mr. Aguirre, testified that he was told by appellant he could change his wet clothes in a house, but he couldn't recall whether the house was located in San Diego or Chula Vista. (R.T. 64). Mr. Aguirre referred to the area where he was picked up in appellant's station wagon as Chula Vista. (R.T. 59, 60, 64, 67, 68).



ARGUMENT

A. THE EVIDENCE IS SUFFICIENT TO SUPPORT THE JUDGMENT

Assuming such a motion was made, the rule in the Federal Court has long been that on appeal the evidence is viewed most favorable to the government.

Glasser v. United States, 315 U.S. 60 (1942)

The Statement of Facts set forth somewhat in detail the various facts that support the judgment. Some of the more potent circumstances are as follows:

Appellant transported the nine illegal aliens and the guide in Mexico just prior to their entry. (R.T. 62). In a short period of time he turned this same vehicle over to the guide in the United States, who transported the aliens. (R.T. 20). Appellant and his family were taking a taxi away from this location, (R.T. 47-48). He told Roberto Aguirre, they could change clothes at his house either in Chula Vista or San Diego. (R.T. 64). Appellant resides in Tijuana but has a house in San Diego. (R.T. 29). Appellant was surprised at the actions of the driver, when he refused to return to the spot where the four aliens were waiting. (R.T. 47-49).

Roberto Aguirre knew appellant as the "Coyote" and was going to pay him (R.T. 71). Appellant told Aguirre in Tijuana to wait at the beach and he returned shortly with the remaining 4 aliens. (R.T. 63).



Judge Plummer filed a Finding of Fact. (C. T. 12-13).

The Finding of Fact is substantiated by the record.

A Finding of Fact by the trial court shall not be overturned unless clearly erroneous.

<u>Arellanes</u> v. <u>United States</u>, 353 F.2d 270, 272 (9th Cir. 1965)

Williams v. United States, 289 F.2d 598 (9th Cir. 1961)

The Motion for a new trial was filed 13 days after the finding of guilt. (C. T. 16-19).

Appellant alleges no newly discovered evidence. To the contrary, he merely desires that he be able to testify as to the reasons for his presence at the scene in Imperial Beach. Surely appellant knew his reasons for being present during the trial.

Appellant's Motion for a new trial was therefore, not timely and the Court is without jurisdiction to grant a new trial. Rule 33, Federal Rules of Criminal Procedure.

Assuming the Motion were timely, denial of such Motion is within the discretion of the trial court and will not be reversed on appeal in absence of showing of abuse of discretion.

Morgan v. United States, 301 F.2d 272 (9th Cir. 1962).

Appellant claims the conviction should be reversed because the evidence is conflicting.

It is not for the reviewing Court to weight the evidence or to determine the credibility of witnesses.



Peek v. United States, 321 F.2d 934 (9th Cir. 1963) cert. denied, 371 U. S. 954.

The verdict is supported by substantial evidence.

B. EVIDENCE OF APPELLANT'S RENTED HOUSE WAS PROPERLY ADMITTED

After being advised of his constitutional rights, appellant admitted that he lived in Tijuana, had a rented house in San Diego and was unemployed, (R.T. 29-31) where the witness Aguirre was presumably being taken to change clothes before appellant transported him to Los Angeles.

The statement of appellant is clearly admissible as an admission.

The rent receipt had been returned to appellant. If he wanted it produced, he could have produced the document. The evidence rule, therefore, does not apply.

C. JUDGMENT OF ACQUITTAL SHOULD NOT HAVE BEEN GRANTED

No Motion for Judgment of Acquittal was made. (R. T. 79). Failure to make such a Motion constitutes a waiver of a claim of sufficiency of the evidence on appeal.

Robbins v. United States, 345 F.2d 930 (9th Cir. 1965)

At the close of the trial the following dialogue was recorded. (R.T.79).

Mr. Gott: "The Government rests, your Honor."

Mr. Corbin: "Your Honor, I would state to the Court that the defense rests at this time and would be prepared to argue the case at this



time without further evidence being presented."

Appellant contends such language constitutes a Motion for Judgment of Acquittal. The Court cannot so find.

See <u>Bell v. United States</u>, 282 F.2d 987, where it was said,

"Although some may believe that judges ought to be endowed with prescient

powers, none has yet suggested that they must be mind readers."

VΙ

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the verdict of guilty in the Court below should be affirmed.

Respectfully submitted,

EDWIN L. MILLER, JR., United States Attorney

SHELBY R. GOTT, Assistant U.S. Attorney

Attorneys for Appellee, United States of America



CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

SHELLY R. GOTT



No. 22132

IN THE

United States Court of Appeals

For the Ninth Circuit

FIREMAN'S FUND INSURANCE COMPANY,

Appellant,

vs.

CHARLES WALKER and HARTFORD ACCIDENT AND INDEMNITY COMPANY, Appellees.

Brief of Appellant

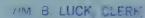
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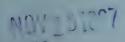
On Appeal from the United States District Court for the District of Montana

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IN THE

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FIREMAN'S FUND INSURANCE COMPANY,

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vs.

CHARLES WALKER and HARTFORD ACCIDENT AND INDEMNITY COMPANY, Appellees.

Brief of Appellant

FIREMAN'S FUND INSURANCE COMPANY

On Appeal from the United States District Court for the District of Montana

STATEMENT OF PLEADINGS AND FACTS ESTABLISHING JURISDICTION

This action was commenced by the Appellees (Plaintiffs below) pursuant to the provisions of 28 U.S.C. A. Sections 2201 and 2202 (Declaratory Judgment); the amount in controvery exceeds Ten Thousand and no/100 Dollars (\$10,000.00) exclusive of interest and costs; one of the Appellees is a citizen of the State of Montana and the other Appellee is a citizen of the State of Connecticut, and the Appellant is a citizen and resident of the State of California. The judgment en-

tered by the Court below is reviewable by this Court pursuant to the provisions of 28 U.S.C.A. Section 2201, and pursuant to the timely filing of Notice of Appeal by Appellant pursuant to the provisions of Fed. Rules Civ. Proc. rule 73, 28 U.S.C.A. Jurisdiction over the person of the Appellant was obtained by proper service of summons by the Appellees. Said Complaint is found on page 1 of the record herein and said summons is found on page 4 of the record herein.

STATEMENT OF THE CASE

The sole issue involved in this case, both in the court below and on appeal to this Court, is the proper interpretation of the "employee exclusion" clause contained in the Appellant's liability insurance policy in issue here. No other coverage question is presented as it is admitted that the injury incurred by one Lester J. Stewart (an employee of the Appellant's insured) was incurred during a loading and unloading operation within the meaning of the Appellant's liability policy. Stewart alleged he was injured through the negligence of the Appellee, Charles Walker (who was an insured of the Appellee, Hartford Accident and Indemnity Company). After this Declaratory Judgment action was filed and during the pendency thereof, and pursuant to stipulation and agreement by the parties hereto, the Stewart personal injury litigation was settled, both Fireman's Fund Insurance Company and

Hartford Accident and Indemnity Company contributing 50% to said settlement pursuant to said stipulation agreement wherein it was agreed that the final prevailing party in this action would be reimbursed by the non-prevailing party.

The sole issue to be determined here is the proper interpretation of the following exclusion clause found in Fireman's policy. This provision, as far as is here relevant, is found on the second page of Fireman's policy under the heading of "EXCLUSIONS" and states that Fireman's policy does not apply:

"(f) under coverage A, to bodily injury to or sickness, disease or death of any employee of the insured arising out of and in the course of (1) domestic employment by the insured, if benefits therefor are in whole or in part either payable or required to be provided under any workmen's compensation law, or (2) other employment by the insured;"

This case was submitted on a statement of Agreed Facts which statement is found on page 37 of the record herein and which statement of Agreed Facts incorporates the policies of both involved insurance carriers. In part the Agreed Facts state that Stewart was employed by Richard Griel (Fireman's insured) and that he was injured while acting in the course and scope of his employment by Griel. It is further agreed that Stewart was, at the time of the accident, covered

by workmen's compensation policy purchased by his employer and that Stewart made claim thereunder and that said claim was accepted as compensable and was further compromised and settled by Stewart and the Montana Industrial Accident Board.

The basic contention of the Appellant herein is, that by virtue of the aforequoted exclusion clause, coverage under Fireman's policy is excluded to any employee of any insured, be he the named insured or any omnibus insured. It is to be noted that the policy defines the unqualified word insured, under the heading "Insuring Agreements", paragraph III, as including the named insured and all other insureds generally referred to as omnibus insured.

The Appellees contend that said exclusion clause is applicable *only* where the employer-employee or master-servant relationship exists between the injured party and the insured seeking the coverage of the policy (in this case the otherwise omnibus insured, Charles Walker).

SPECIFICATION OF ERROR

The sole "specifications of error" herein consist of the OPINION and ORDER of the lower court which is dated May 31, 1967, and filed on June 5, 1967, and which is found on page 82 of this record and the judgment entered pursuant thereto, which judgment is dated June 23, 1967, and filed and entered June 27, 1967, and found at page 86 of this record.

ARGUMENT

The Court's attention is first invited to the fact that, under the heading "Insuring Agreements" of Fireman's policy and more specifically paragraph III thereof, the word insured is defined. It is therein set out that the unqualified word "insured" includes the named insured and also any other insured, generally referred to as an omnibus insured. While Charles Walker was not the named insured it is admitted that he would be an omnibus insured except for the fact that, in this case, the injured party seeking redress was an employee of an "insured" (in this case the named insured).

On the second page of Fireman's policy and under the heading "EXCLUSIONS" it will be seen that the policy does *not* apply:

"(f) under coverage A, to bodily injury to or sickness, diesase or death of any employee of the insured arising out of and in the course of (1) domestic employment by the insured, if benefits therefor are in whole or in part either payable or required to be provided under any workmen's compensation law, of (2) other employment by the insured;"

This precise question has been litigated with a surprising amount of frequency in the various state and federal jurisdictions around the nation. Admittedly there is some split of authorities on the issue. However, and as we shall clearly demonstrate, by far the majority of the decisions favor Fireman's position. It should also be noted that there is a definite trend in the more recent cases to so hold. Also we contend that the better reasoned cases support our position herein.

In general the basic reasons given by the various courts which have held that the word "employee" as used in both of these exclusion clauses refers to an employee of any insured are as follows:

- 1. That since the policy *itself* defines the unqualified word "insured" as any insured, either omnibus or named, then there cannot conceivably be any ambiguity requiring any interpretation.
- 2. That it is most unreasonable to interpret the exclusion provision as being inapplicable to an ombnius insured (except where the injured party is an employee of the omnibus insured) as this would be granting more protection to an omnibus insured than to a named insured when the latter actually takes out the policy and pays the premiums thereon.
- 3. That since the only "rationalization" for holding as contended by Hartford is first, the finding of "ambiguity" within the policy and then following the rule of resolving all ambiguities against the insurance company, to provide any and all possible persons with coverage, when

under circumstances such as there, the rule is inapplicable since in any event there would be coverage, therefore there is no reason for the rule, thus the rule itself should fail.

4. That any reasonable reading of such exclusion clauses plainly shows that the intent of the insurance industry, through their policies, is to exclude coverage to insured employers, whether they be named or omnibus, from suits by their own employees while still providing coverage for the public in general.

As a result of the undersigneds' research, it would appear that the law of the great majority of the jurisdictions has been interpreted as contended by Fireman's, said interpretations being either a result of a state court's or of federal court's decisions involving state law. It also appears that such a result has been arrived at in the Fourth, Fifth, Sixth, Seventh, Eighth and Tenth Circuits. It is also interesting to note that of the many decisions which support Fireman's position, eighteen have been decided between 1960 and 1967 inclusive. It is believed that this latter fact clearly discloses the modern trend is strictly adverse to Hartford's position herein.

The following citations and quotations are all from cases involving identical or very similar worded policies, (except as otherwise noted). It will be noted that these opinions give various reasons for their holdings, all of which are, however, basically contained in

the four (4) foregoing general statements. All involve similar factual situations.

Kelly v. State Automobile Insurance Association, 288 F.2d 734 (1961) (6th Cir.) (Ky.) (Reaffirmed in Am. Fid. & Cas. Co. v. Indemnity Inc. Co. of No. Am., 308 F.2d 697, (1962).)

"In our case, the policy excluded coverage for bodily injury liability to 'any employee of an insured. * * *' It would seem clear that Underwood [truck owner] was 'an insured,' in fact the named insured which had taken out and paid for the policy of insurance. Rothast [plaintiff in tort case] was its employee and was injured while in its employment. The remainder of the exclusion excepted a domestic employee not covered by workmen's compensation.

"Certainly Underwood, having paid for workmen's compensation insurance for the protection of its employees would not ordinarily take out liability insurance at its own expense to protect itself from any claim its employees might have against it or any third person. In other words, Underwood was paying for the protection of its liability insurance against claims asserted by the public, and not by its own employees.

"In our judgment, if it was intended by the severability of interests clause to provide coverage in a case like the present one, the language used was inadequate for that purpose. We can only enforce the policy as it was written.

"The judgment of District Court, therefore, is affirmed."

United States Fidelity and Guaranty Co. v. American Fidelity and Casualty Co., 299 F.2d 215 (1962) (7th Circuit) (Ind.) (Reaffirmed in Farrell v. State Auto Ins. Assoc., 303 F.2d 897 (1962).)

"In the Michigan Mutual case, [297 F.2d 208], we approve the principle announced in decisions such as American Fidelity and Casualty Co. v. St. Paul-Mercury Indem. Co., 5 Cir. 248 F.2d 509; Michigan Mutual Liability Co. v. Carroll, e tal., 271 Ala. 404, 123 So.2d 920; Transport Insurance Co. v. Standard Oil Co. of Texas, 161 93, 337 S.W.2d 284. We specifically held, at page 211, that "* * there is no liability when an employee of the named insured is injured while engaged in the employ of said insured."

"We further stated in the Michigan Mutual case, at pages 211-212 'Considering the definition of the insured as contained in the policy, the clause may be read as follows: "This policy does not apply * * * to bodily injury to * * * any employee of the [named] insured while engaged in the employment of the [named] insured, * * *." The language seems to be unambibuous and clearly states that the policy does not cover accidents which result in injuries to the employees of the insured.'

66* * *

"The decision of the District Court herein was prior to the date when he announced the decision in the Michigan Mutual Liability Company case. As hereinbefore indicated, there is considerable authority to support the view adopted by the District Court in the case at bar. However, consistent with our decision in Michigan Mutual Liability Co. v. Continental Casualty Company, et al., supra, and with decisions of the Courts of Appeal in the Fourth, Fifth and Sixth Circuits, we must and do hold that the judgment of the District Court be Reversed."

Lumber Mutual Casualty Ins. Co. of New York v. Stukes, et al, 164 F.2d 571 (4th Cir.) (1947) (S.C.)

"* * It will be noticed that the language is 'the insured' and not 'the named insured', the latter being the language used in the policy where the intention is to designate only the person to whom the policy is issued; and the omnibus coverage clause, as above pointed out, defines the word 'insured' as used in the policy so as to include any person using the automobile with the permission of the named insured. The purpose of the exclusion clause is to limit coverage to liability for injury to members of the general public and to exclude liability to employees of the insured. (Citing cases).

"There can be no question that the purpose was to apply the exclusion to employees of an additional insured as well as to those of the named assured, when consideration is given to the clause providing that the omnibus coverage clause shall not apply where the person injured is an employee of the same employer as an employee driving the

car. It is true that if Timmons was an independent contractor he would not be an employee operating the car, and this clause would have no application to him; but its use in the policy shows clear intention that coverage shall extend only to liability to the public and that there shall be no coverage in the case of employees of an insured. * * *" (Emphasis supplied)

G. C. Kohlmier, Inc. v. Mollenhauer, 140 NW 2d 47 (Minn.) (1966).

"The fact that other unnamed persons are given protection as omnibus insured under the same policy is certainly no reason for extending their coverage beyond that which the named insured has prudently afforded himself.

66* * *

"The court in American Fidelity & Cas. Co. v. St. Paul-Mercury Ind. Co., 248 F.2d 509-5th Cir., has also handled effectively the argument that the proposed application of the exclusion clause in this case would commit the court to the anomalous position of denying the named insured coverage when the person injured is an employee of an omnibus insured. That court was not so committed, and indeed this court has already held that the named insured will not be denied coverage in such a situation. When the named insured is denied coverage, an ambiguity does arise since this result would obviously be contrary to the basic intent of the contracting parties to provide the named insured adequate protection. Then the 'plain meaning' of the language must give way to the intentions of the contracting parties. In the case at bar the 'plain meaning' of the exclusion clause must prevail."

Transport Insurance Company v. Standard Oil Company of Texas, 337 S.W.2d 284 (1960) (Tex.)

"The exact question involved is one of first impression in this jurisdiction. There is a split of authority in other jurisdictions, but the weight of authority is that if the injured party is the employee of any person who is insured under the policy, the employee exclusion is applicable although he may not have been an employee of the person committing the tort. See 50 A.L.R.2d 99. The cases which support Transport's contention follow the weight of authority and apply the language of the policy as written.

66* * *

"In summation, since Annis was an employee of Transport Company of Texas, an insured under Transport's policy, and was injured in the course of such employment, and since exclusions (f) and (g) in plain and unequivocal language provide that the policy affords no coverage against the claim of an employee of the insured, and since the words 'against whom the claim was made' are not to be added to the contract, the judgment of the trial court in favor of Transport should be affirmed." (Emphasis supplied)

Simpson v. American Automobile Insurance Company, 327 S.W.2d 519 (1959) (Mo.)

"We find no ambiguity in the use of the word 'insured' in the exclusion clause. Its meaning when used in any clause of the policy was clearly defined in the omnibus clause of the policy. We have no right to find ambiguity where none exists merely for the purpose of invoking the rule that where ambiguity exists the construction most favorable to the insured must be adopted. As we said earlier, we are not permitted to exercise inventive powers or engage in perversion of language for the purpose of creating an ambiguity when none exists. (Citing case)

"Included in the points relied on by appellants is one that a policy covering an additional insured or insureds is in legal effect two policies of insurance: one a contract between the insurer and the named insureds and the other a contract between the insurer and the additional insureds and even though one of them shall be denied coverage, that alone will not prevent coverage of the others, despite the fact that the additional insureds' coverage may be broader than the named insureds'. It seems to us that the proposition contains its own condemnation. There is only one contract of insurance contained in American's policy and it must be construed as a whole. The additional insureds cannot claim coverage under the omnibus clause, which gives them coverage as additional insureds through definition of insureds, and then seek to ignore that very definition that gives them coverage, when considering the exclusion clause. The contention of appellants is unsound." (Emphasis supplied)

Fireman's Fund Indemnity Co. v. Mosaic Tile Co., 115 S.E.2d 263 (Geo.) (1960).

"* * * There is no dispute that the word 'insured' as so defined does extend the initial coverage of the insurance to the plaintiff Mosaic Tile Company, but is contended by Mosaic that the defined meaning of the word 'insured' does not apply to it as to the exclusions in the policy. We cannot agree with this contention, for a contract of insurance clearly defining the meaning of the word 'insured' which leaves no ambiguity or deceptive verbiage, is not open to construction, and the literal meaning must be attributed to it. If the exclusion applies to include also an additional insured, in this case the Mosaic Tile Company, then Mosaic in the final analysis has no coverage under this policy for the bodily injury. **(**(* * *

"It seems clear, then, by the terms of the policy itself that the word 'insured' when unqualified had a definite scope and meaning and that the words 'named insured' had a more restricted and narrow meaning. These two disparate meanings seem obvious in the contents of the policy. Therefore, there is no ambiguity in this insurance policy as to these matters, and so no construction is required or permissible. The language must be given its literal meaning and the words their plain and ordinary effect as defined in the policy. (Citing cases)

"The trial court erred in adjudging that the plaintiff was entitled to the protection of the policy, and erred in refusing and declining to vacate and set aside its judgment." (Emphasis supplied)

General Accident Fire and Life Assurance Corporation, L.T.D., et al., v. Ray Brown, et al., 181 N.E.2d 191 (Ill.) (1962).

"* * The exclusionary clause does not attempt to say who is an 'insured' within its scope. Elsewhere in the policy, however, the 'unqualified word "insured"' is defined to include both the named insured and all those qualifying as additional insureds. There is nothing whatsoever in the policy to suggest that this definition is not intended to apply to the use of othe word 'insured' in the exclusionary clause. We think it clear that such definition was meant to apply. Had there been any intention to confine the term 'insured' in the exclusionary clause to the 'named insured,' the latter phrase certainly would have been used, just as it was used elsewhere in the policy, when intended. * * *

66* * *

"We must enforce the policy as written, and it is our opinion that the word 'insured' in the employee exclusionary clause of Employers' policy plainly means 'anyone who is insured under the policy.'"

Birrenkott, v. McManamay, et al., 276 N.W. 725 (S.D.) (1937).

"Appellant contends upon this appeal that the exemption clause relating to 'employees of the as-

sured' should be limited to employees of the person for whom the policy is invoked, namely, Mc-Manamay. This court cannot agree with the contention of appellant. Such an interpretation of the exemption clause would mean that the policy offered greater protection from liability to one who obtained the consent of the assured to use his vehicle than it offered to the assured himself. It is the opinion of this court that when the clause in the policy protecting any person operating the insured vehicle with the consent of the assured is invoked, that the person invoking said clause is placed in the same position as the named assured. He is therefore subject to the general limitations of the policy in the same manner as the named assured would be * * * "

Associated Indemnity Corporation v. Wachsmith, 99 P.2d 420 (Wn.) (1940) (Reaffirmed in Utah-Idaho Sugar Company v. Washington Farm Mutual Insur ance Company, 331 P.2d, 538 (Wn.) (1958).)

"We do not think this contention can be sustained, because, as the unqualified term 'insured' is defined in the policy to mean and include 'every person entitled to protection hereunder, 'surely it cannot be logically contended that R. Wachsmith, Sr., the one to whom the policy was issued, and who paid for it, is not entitled to protection under the policy. If this be true, then it must follow, we think, that R. Wachsmith, Sr., is an insured under the policy at all times, and that Buss, being his employee at the time he was injured, is not covered by the policy, regardless of

whether or not Buss was also an employee of Richard Wachsmith, Jr., the additional insured and judgment debtor herein. The trial court concisely summed up the matter in his memorandum opinion, when he stated: 'It seems to the court, also, that the definitive clause supports this conclusion. It states that "the unqualified term 'insured' shall include every person entitled to protection hereunder * * *" Certainly, the named assured is one entitled to protection under the policy; therefore, he is included within the meaning of the term "insured". Since he is so included, Buss, as his employee, comes directly within the terms of the "Risks Not Covered" paragraph."

United States Fidelity and Surety Company v. Western Casualty and Surety Company, 408 P.2d 596 (Kan.) (1965).

"We find no ambiguity in the language used. We should not seek ambiguity where none exists merely for the purpose of invoking the rule of liberal construction.

"In a case involving a dispute between two insurance companies we do not have occasion to apply the rule of liberal or extended interpretation which is sometimes necessary to protect a layman in the coverage which he thought he was receiving.

"In Esfeld Trucking, Inc., v. Metropolitan Insurance Co., 193 Kan. 7, 392 P.2d 107, we stated:

'We believe the policy is clear and unambiguous and there is no need for judicial interpretation or the application of rules of liberal construction (citing case) particularly since this is an action between two insurance companies who draw their own policies and should know the meaning of the words used in those policies as they are understood in the general field of insurance.'

"We conclude that if an injured party is an employee of the named insured under an automotive liability policy, he is excluded by a provision which excludes 'bodily injury to an employee of the insured arising out of and in the course of employment * * * by the insured' even though he may not have been the employee of an unnamed insured under the policy whose employees committed the tort.

"The exact question involved is one of first impression in this jurisdiction. There is divided authority in other jurisdictions but the great weight of authority appears to be in harmony with the views expressed herein. The cases from other jurisdictions have become too numerous to justify citation for the purpose of classification. Those wishing to research the cases should see the annotation in 50 A.L.R.2d 78 and A.L.R.2d, Supplemental Service, Vol. 2, p. 3203 and Vol. 4, p. 1138." (Emphasis supplied)

Benton v. Canal Insurance Company, 130 So.2d 840 (Miss.) (1961).

"In the case we have here, the policy issued by Canal to Stubbs was written for the benefit of Stubbs to protect him from liability for injuries to third parties. The policy excluded coverage for injuries to Benton, an employee of Stubbs, the named insured. Western Casualty and Polk were not parties to the contract of insurance and had nothing to do with the writing of the policy. Polk was not a named insured. Polk was an employee of the Steel Corporation. He claims under the Canal policy only as an additional insured under the general language of Insuring Agreement III. Under these circumstances it seems strange indeed that Polk should claim, or that there should be claimed for him, more protection under the policy of Stubbs than Stubbs, the named insured, who paid for the policy, could claim for himself. Yet Polk and Western Casualty, as Benton's assignee, now seek to recoup from Stubbs' insurance carrier the amount of the judgment rendered against Polk and his employer in favor of Benton for injuries suffered by Benton as a result of the negligence of Polk and his employer. by having the court construe the words 'any emplovee of the insured', as they appear in the Exclusions clauses of Canal's policy, to mean 'any employee of the insured against whom liability is sought to be imposed.' This we cannot do. The language of the policy is unambiguous. Since the language is plain and unambiguous there is no occasion for construction, and the language must be given its plain meaning. * * *" (Emphasis supplied)

Auto Racing, Inc. v. Continental Casualty Company, 304 F.2d 697 (10th Cir.) (1962) (this case has reference to a differently worded exclusion clause but affirms the general proposition).

"It is settled law that the primary purpose of an exclusion clause in a public liability policy, such as we have here under consideration, is to draw a sharp line between employees who are excluded and members of the general public. State Farm Mut. Automobile Ins. Co. v. Braxton, 4 Cir. 157 F.2d 283, 285. There can be no question but that the purpose was to apply the exclusion to employees of an additional insured as well as to those of the named insured. Lumber Mutual Casualty Inc. Co. of New York v. Stukes, 4 Cir. 164 F.2d 571. The purpose of the exclusion clause is to limit coverage of liability for injury to members of the general public and to exclude liability to employees of the insured. (Citing cases.)" (Emphasis supplied)

Buhonick v. American Fidelity & Casualty Company, 190 F. Supp. 399 (1960).

"For purpose of deciding the issue herein posed, it is incumbent upon me, therefore, to determine how the appellate court of Indiana would resolve this same question if squarely prsented to that court.

"In approaching the problem, it is my judgment that the dominant appellate decisional conclusions throughout the United States should be given great weight in projecting and prognosticating the law of Indiana.

"In spite of the conflict of authorities which exist from other states, I am satisfied that the weight and best reasoned authorities hold to the view that the exclusion provision applies to employees of an additional assured as well as to those of the named assured. (Citing cases)." (Emphasis supplied)

In addition to all the foregoing quoted cases the following listed cases also hold to precisely the same effect as those we have quoted from. However, in the interests of keeping from making this brief too cumbersome we shall merely list the following cases and respectfully invite the Court's attention to the same as they all unequivocally support the Defendant's position in this Declaratory Judgment action. These additional cases are:

- Campbell v. American Farmers Mutual Insurance Co., 238 F.2d 284 (8th Cir.) (1956) (Mo.);
- Miller and Buchong, Inc. v. Travelers Insurance Company, 231 F. Supp. 128 (1964) (Penn.);
- Michigan Mutual Liability Co. v. Carroll, 123 So.2d 920 (Ala.) (1960);
- Connelly v. London & Lanchire Indemnity Co., 28 A.2d 753 (1942) (R.I.);
- Farmers Elevator Mut. Ins. Co. v. Austad, 366 F.2d 555 (8th Cir.) (1966) (N.D.);

Ohio Casualty Insurance Company v. U. S. F. & G., et al., 223 N.E.2d 851 (Ill.) (1967);

Vaughn v. Standard Surety & Casualty Co., 184 S.W.2d 556 (Tenn.) (1944)

Humble Oil & Refining Co. v. American Fidelity & Cas. Co., 232 F.Supp. 953 (1962) (Va.);

American Fidelity & Casualty Co. v. Indemnity Insurance Company of North America, 195 F. Supp. 648 (1961) (Ohio) (affirmed in 308 F.2d 697, cert. denied 372 U.S. 942, 83 S. Ct. 935);

American Fidelity Co. v. Deerfield Valley Grain Co., 43 F. Supp. 841 (Vt.) (1942);

Maryland Casualty Company v. American Fidelity and Casualty Company, 330 F.2d 526 (6th Cir.) (1964) (Tenn.);

State Farm Mutual Ins. Co. v. Employers Fire Ins. Co., 123 S.E.2d 108 (N.C.) (1961).

Finally in this connection we would like to call the Court's attention to American Fidelity and Casualty Co. v. St. Paul-Mercury Indemnity Company, 248 F.2d 509 (1957). This is an opinion from the Fifth Circuit and we believe it to contain one of the most thorough discussions on this particular problem which we have yet found. In view of the fact that so much of the opinion is so valuable and relevant it would be impossible to do justice by quoting mere portions therefrom. It is with this thought in mind that we

respectfully request that this Court review the entire opinion.

The Court's attention also again is invited to the second page of Fireman's policy and under the heading "EXCLUSIONS" will be seen that this policy does not apply:

"(e) under coverages A and B. to any obligation for which the insured or any carrier as his insurer may be held liable under any workmen's compensation, unemployment compensation or disability benefits law, or under any similar law;"

All of the foregoing law, of course, is equally applicable to this exclusion, as the same issue arises—namely whether or not the word insured as used therein means the named insured, all insureds or only the insured seeking protection of the policy. A number of the hereinbefore cited cases also refer to this particular exclusion and therefore whatever interpretation is accepted in reference to subsection (f) of the exclusions is equally applicable to subsection (e).

FEDERAL DISTRICT COURT OPINION AND ORDER

While the district court decision was adverse to Appellant's position, nevertheless it is extremely clear that Judge Smith so held with a great deal of reluctance. This Court's attention is invited to the lower court's opinion and order (page 82 of this record)

and more specifically to page 2 thereof wherein Judge Smith spoke, in part, as follows:

"Had no court considered this problem, and were this a case of first impression, I would be persuaded to adopt the defendant's position and hold that the language of the policy is not ambiguous, and the unqualified use of the word 'insured' in the exclusion clauses included both the named insured and the omnibus insured and their respective employees. Here, however, I must determine what path the Montana Supreme Court would take in light of all that has been written by many courts."

and further on at page 3 of said opinion and order:

"* * * the real fact of this diversity of opinion bewteen courts and within courts overcomes the conclusion that I would reach were I left alone with nothing but the words of the policy to consider." (all emphasis supplied)

It thus is clear that Judge Smith's own judicial opinion was in conformity with the Appellant's position herein, but for some reason, he feels that the Montana Supreme Court would not agree.

As above noted, Judge Smith stated in his opinion that his holding would be different if he were "* * *

left alone with nothing but the words of the policy to consider." We respectfully submit that Judge Smith erred in not doing that, as the Montana Supreme Court has clearly committed itself to such a principle of insurance contract interpretation. And it precisely so held in 1957 in the case of James v. Prudential Insurance Company of America, 312 P.2d 125 (127) wherein the Montana Supreme Court spoke as follows:

"The plaintiff urges a number of cases to the effect that an uncertain contract should be interpreted most strongly against the party causing the uncertainty. Such is the Montana rule. R.C.M. 1947, § 13-720. But even though it is a cardinal principle of insurance law that a contract of insurance is to be construed liberally in favor of the insured and strictly against the insurer, contracts of insurance should be given a fair and reasonable construction. Park Saddle Horse Co. v. Royal Indemnity Co., 81 Mont. 99, 111, 261 P. 880. In arriving at such construction, no matter how strictly construed against the insurer, the intention of both insurer and insured is to be ascertained from the language of the policy. R.C.M. 1947 § 13-704. Effect must be given to every part of the policy contract. R.C.M. 1947, § 13-707. The words of the contract are to be understood in their usual meaning R.C.M. 1947, § 13-710. Common sense controls. (Emphasis supplied)

In this same connection please see the Montana case of Johnson v. Metropolitan Life Insurance Co., 83 P.2d 922 (1938) wherein the court, after stating that the rights and liabilities of the parties are gov-

erned by the *provisions* of the policy, goes on to state, on page 924 of the Pacific Reporter as follows:

"* * * On the other hand, if there is no ambiguity [meaning within the policy] and the provisions of the contract of insurance are plain and clear and lend themselves to but one construction, it is the duty of the court to give to the contract that one plain and clear construction, and not to attempt to rewrite for the parties a contract differing from one to which the parties agreed. In this latter respect a contract of insurance does not differ in its construction from any other contract. It is incumbent on this court to examine the four corners of this contract to determine whether such ambiguity exists (citing cases), and if it does not, then this court is powerless to make a contract for the parties contrary to the one expressed in the agreement. (citing cases.)"

In view of the foregoing, and particularly since Judge Smith expressly states that he can find no ambiguity within the policy, it is respectfully suggested that Judge Smith erred in that he apparently confused what he found to be "ambiguity" among the various decisions, as being synonymous with ambiguity within the policy. This clearly is not Montana law.

Perhaps this would be the proper place to inform this Court that the following cases, all very recently decided, had not been reported at the time the briefing was done for the District court and consequently were not called to Judge Smith's attention. All three cases unequivocally support the Appellant's position herein. These cases are: Farmers Elevator Mutual Insurance Co. v. Austad, 366 F.2d 555 (8th Cir.) (1966) (N.D.; Ohio Casualty Insurance Company v. U.S.F.&G., et al, 223 N.E.2d 851 (Ill.) (1967); St. Paul Fire & Marine Insurance Co. v. Wabash Fire & Casualty Insurance Co., 264 F.Supp. 637 (Minn.) (1967).

One of the most important developments that has occurred since the rendition of Judge Smith's Order herein, is the fact that a Montana District Court has had the precise same point before it and has held adversely to Judge Smith's ruling.

In the case of "The Travelers Insurance Company, a corporation, Plaintiff v. American Casualty Company of Reading, Pennsylvania, a corporation, et al, Defendants" the Honorable Paul G. Hatfield, Judge of the Eighth Judicial District of the State of Montana, had the precise question before him, based on identically worded exclusions. Obviously it was encumbent upon Judge Hatfield to apply Montana law to the issue. The action was also a declaratory judgment action. The Travelers case was argued on June 20, 1967, (the district court's order herein having been made on May 31, 1967) and Judge Smith's decision herein was argued by the Defendant, American

Casualty Company, in support of its position (the same position as Hartford's herein). The undersigned was personally present at the argument and in fact participated therein as this firm represents one of the parties to the Travelers case. Obviously Judge Hatfield did not subscribe to Judge Smith's opinion as evidenced by the following excerpts from the Findings of Fact, Conclusions of Law and Judgment entered by Judge Hatfield on July 12, 1967.

Paragraph VI of the Findings of Fact reads, in its entirety, as follows:

"The word 'insured' in the American Casualty Company policy is defined, so far as here material as follows:

"III Definition of Insured: The unqualified word "insured" includes the named insured and also includes . . . (2) under coverages A and C any person while using an owned automobile . . . any person or organization legally responsible for the use thereof, provided the actual use of the automobile is by the named insured or with his permission . . . '

(Sheet 2 of Exhibit "D", Agreed Statement) Under the section covering "Exclusions" said American Casualty Company policy provides:

'This policy does not apply:

'(f) Under the coverages A and B, to any

obligation for which the insured or any carrier of his insurer may be held liable under any workmen's compensation, unemployment compensation or disability benefits law, or under any similar law;

'(g) Under Coverage A, to bodily injury or to sickness, disease or death of any employee of the insured arising out of and in the course of (1) domestic employment by the insured, if benefits therefor are in whole or in part either payable or required to be provided under any workmen's compensation law, or (2) other employment by the insured;'

(Sheet 3 of Exhibit "D", Agreed Statement)"
The following is an excerpt of Paragraph II of the
Conclusions of Law in the Travelers case:

"The language of the American Casualty Company policy is not ambiguous, nor is it made ambiguous by the "Severability of Interests" clause contained therein, and the said American Casualty Company policy specifically excludes coverage, either to the named insured or to any omnibus insured, under Exclusions (f) and (g) hereinabove referred to, with respect to bodily injury to Bert W. Court, as claimed in said Civil Action 63674-B, and is likewise excluded with respect to any other person and the State of Montana who now or may hereafter claim under said Bert W. Court."

It will be noted that "Exclusion (f)" of Travelers policy is identical to "Exclusion (e)" of Fireman's

policy herein and that "Exclusion (g)" of Travelers policy is identical to "Exclusion (f)" of Fireman's policy. It will also be noted that the definition of the unqualified word insured is identical in both policies.

(The Findings of Fact, Conclusions of Law and Judgment in the Travelers case are found in their entirety, as Exhibit "A" to Appellant's Affidavit in Support of its Motion for Extension of Time and "Abstention" and which is on file herein.)

The Travelers Insurance Company has appealed Judge Hatfield's order to the Montana Supreme Court and that appeal is presently pending and will be decided in the near future, although obviously, the writer cannot state just when. However, in view of the fact that the Montana Supeme Cout does, and has for some years past, decided cases with great dispatch, it is suggested that this decision will be forthcoming in the near future. At this point we might again, if the same is proper, call the Court's attention to our Motion for Abstention for all of the reasons set out in the affidavit in support thereof, which will not be repetitiously set out herein.

We, of course, realize that this Court is certainly not bound by the holding of a state district court, but we do suggest that the same is entitled to great weight herein because of the presumption of the correctness of the lower court holding.

CONCLUSION

The actual question to be determined by this Court is what the contracting parties to the Fireman's policy agreed to as determined from the language of the policy. Is it reasonable to hold that, when the policy itself defines the unqualified word insured as including all insureds, nevertheless it means something different *only* when used in the exclusion clauses? Is it reasonable to assume that the named insured, who pays the premium on the policy, intended to contract for and receive less coverage than some "fortuitous" omnibus insured? We suggest that such is grossly unreasonable.

Respectfully submitted.
KELLER, MAGNUSON AND REYNOLDS
AND GLEN L. DRAKE
DAVID O. DEGRANDPRE

By:			
	Attorneys	for	Appellant.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is

in full compliance with those rules.

Attorney



IM. B. LUCK, CLERK

No. 22132

DEC 4 1967

IN THE

United States Court of Appeals

For the Ninth Circuit

FIREMAN'S FUND INSURANCE COMPANY,

Appellant-Defendant

vs.

CHARLES WALKER and HARTFORD
ACCIDENT AND INDEMNITY COMPANY,
Appellees-Plaintiffs

Brief of Appellees-Plaintiffs

On Appeal from the United States District Court for the District of Montana

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DEC 4 1967



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IN THE

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For the Ninth Circuit

FIREMAN'S FUND INSURANCE COMPANY,
Appellant-Defendant

vs.

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Appellees-Plaintiffs

Brief of Appellees-Plaintiffs

On Appeal from the United States District Court for the District of Montana

STATEMENT OF JURISDICTION

The plaintiffs and appellees concur in the appellant's "Statement of Pleadings and Facts Establishing Jurisdiction" set forth on pages one and two of appellant's Brief.

STATEMENT OF CASE AND ISSUE

The case statement of the defendant-appellant, Fireman's Fund, is fair. Briefly, an employee (Stewart) of Richard Griel (Fireman's Fund named insured) was injured on October 26, 1965 in the process of loading logs on the Griel truck. The claim was that the heel boom operator, Danny Walker, employed by plaintiff-appellee Charles Walker, was negligent.

There is no dispute the Fireman's Fund truck policy provided liability coverage while the vehicle was being loaded or unloaded with the permission of Griel.

Danny Walker, younger brother of plaintiff Charles Walker, was not sued; it is his brother who is claiming primary coverage under the Fireman's Fund policy as an omnibus insured. By happenstance, Walker had his heel boom insured with Hartford and there is no honest dispute that the Hartford policy would be excess if the limits of the Fireman's Fund truck policy were exhausted.

The Hartford policy provides that it is excess if there is other insurance concerning the use of any non-owned automobile. (Condition 14, Hartford policy) Both policies seem to be identical in all material respects.

It is further agreed that neither Danny Walker nor his employer, plaintiff Walker, employed injured party Stewart. Stewart sued appellee Walker in Montana State Court for the sum of \$172,000.00 on April 6, 1966. Defense was tendered appellant who refused. This declaratory action was instituted September 16, 1966.

The sole issue is, as counsel for Fireman's Fund states on page three of their brief — Does the exclusion clause eliminate coverage from Walker because Stewart was an employee of the named insured but not omnibus insured, Walker?

The answer is no and primary coverage rests with Fireman's Fund as will be detailed below.

The transcript of the record which the appellees and plaintiffs have is not numbered. References, when neces-

sary, will be made to the opinion of District Judge Russell Smith found in 268 F.S. 899, Montana, 1967. (Italicized insertions are those of appellees)

ARGUMENT

1. Effect of Trial Judge's Findings and Conclusions

The opinion and order of Trial Judge Russell Smith (page 82 of transcript, 268 F.S. 899) served as Findings of Fact and Conclusions of Law pursuant to Rule 52(a), Federal Rules of Civil Procedure. This was a non-jury declaratory judgment action and this court has declared this to be the rule:

"It is not the function of this court to retry cases on appeal. Findings of Fact by the trial court are presumptively correct and will not be set aside unless clearly erroneous... The party seeking to overthrow findings has the burden of pointing out specifically wherein the findings are clearly erroneous." (Glens Falls Indemnity Company v. United States, 229 F.2d 370, 373, 9th CA, 1955)

The Tenth Circuit declares the appellate guidelines to be that, unless "clearly erroneous" the determination by the trial courts of the applicable (Colorado in that instance) state, the rule will be upheld. (Bushman Construction Company v. Conner, 351 F.2d 681, 684; cert. denied, 384 U.S. 906, 10th CA, 1965)

It is to be recalled now that District Judge Smith found as a fact that the policy was ambiguous, pointing out the conflict of appellate decisions. We certainly do not agree with appellant's position that the "great weight of authority" is opposed to the ambiguity or the effect

of the employee exclusion not applying to an omnibus insured whose own employee is not asserting protection of the truck policy against him.

This Court has said:

"We are required to attach great weight to the District Judge's determination as to the law of the particular state in which he sits . . . It is the duty of a Federal Court, where state law is to supply the rule of decision, to ascertain and apply that law as it may be seen or anticipated." (Insurance Company of North America v. Thompson, 381 F.2d 677, 681, 9th CA, 1967)

Incidentally, in a very well-reasoned case sustaining the position of the plaintiffs and appellees, it has been said that, "while ambiguity may have its greatest merit in instances of disagreement between the actual contracting parties, it has been applied in numerous situations concerning the loading and unloading coverage." (Johnson, Drake and Piper, Inc. v. Liberty Mutual Insurance Co., 258 F.S. 603, 610, Minn., 1966, and cases collected at 95 A.L.R. 2d 1122-1153, supplementing 160 A.L.R. 1259 and see 50 A.L.R. 2d, Section 6, page 97, which concerns the issue here presented.)

It is elemental, of course, that Montana law would be controlling here, this being an insurance contract by Fireman's Fund made in Montana with a Montana resident and the accident occurred in Montana. (Dickinson v. General Accident Fire and Life Assurance Corp., 147 F.2d 396, California, CA, 1945; American Mutual Liability Insurance Co. v. Goff, 281 F.2d 689, California, CA, 1960;

Capitol Finance Corp. v. Metropolitan Life Insurance Co., 75 Mont. 460, 464, 243 Pac. 1061; Sec. 13-712, R.C.M., 1947.)

2. Montana Insurance Principles

In a decision rendered October 27, 1967, the Montana Supreme Court re-affirmed the following language, which is patently applicable to Judge Smith's fact finding of ambiguity:

"But if the terms of the policy are ambiguous, obscure, open to different constructions, the construction most favorable to the insured (Charles Walker) or other beneficiary (Stewart) must prevail." (St. Paul Fire & Marine Insurance Co. v. Thompson, Mont....,P.2d....., 24 St. Rep. 714, 717, quoting Eby v. Foremost Insurance Company, 141 Mont. 62, 66; 374 P.2nd 857, 1962)

Again, in 1967, the Montana court noted our statute, Section 13-720, R.C.M., 1947, which declares:

"... A contract should be interpreted most strongly against the party who caused the uncertainty to exist . . ."

This means, among other things, that in cases of uncertainty every doubt should be resolved in favor of the insured and the policy should be construed strictly against the insurer. (Niewoehner v. Western Life Insurance Company, 148 Mont......, 422 P.2d 644, 648, 1967)

District Judge William Jameson collected the Montana cases on this well-known universal rule of liberal construction in Kansas City Fire & Marine Insurance Co. v.

Clark, 217 F.S. 231, 235 (D.C. Mont. 1963) an opinion "... with which we fully agree ..." this court said at page 647 of 329 F.2d. This point of liberal construction need not be belabored further, except to observe the application of the rule to this appeal:

"Here the insured Walker is not concerned because his comprehensive policy with Hartford would cover the loss, but the effect of this decision is to increase Walker's coverage and to extend protection to those in Walker's position who are not otherwise covered. For that reason the interpretation here reached does favor the insured.." (Note 11, 268 F.S. at 902)

3. Intent of Loading and Unloading and Omnibus Insured

The appellees submit this brief could be terminated here; that is, the trial judge has found as a fact there is an ambiguity in the truck policy of Fireman's Fund. This fact is not "clearly erroneous" (Fireman's admit there is a split of authorities on the issue, brief p.6), and the Montana law is to construe such an ambiguity against the carrier and such a construction does give greater protection to Walker, the omnibus insured. As is noted above, the policy of Hartford on the crane would be excess after the Fireman's limits are exhausted. There is no problem in this case, however, about exhausting Fireman's limits. For the court's information, the compromise of the claim of Lester J. Stewart against Charles Walker, was resolved for \$18,100.00. The State claim by Stewart against Walker which Fireman's Fund refused to defend, was for \$172,000.00 as observed above, and far in excess of Walker's \$25,000 coverage by his Hartford policy.

However, to rule out any doubt in the court's mind, we turn to the "intent" of the loading and unloading coverage, the omnibus insureds, and the decisions which support the trial court's judgment. This, and being repititious, is simply that the employee exclusion of Fireman's policy, quoted on page 5 of appellant's brief, applies only to an employee of the omnibus insured claiming coverage.

Insurance is a contract, of course, and must be so interpreted as to give effect to the intention of the parties. (*Rice Oil Co.* v. *Atlas Insurance Co.*, 102 F.2d 561, 522, 9th CA, 1939)

No contention is made by the appellant that the loading and unloading coverage has no meaning whatsoever. It is agreed Walker's employee was "loading" logs on the Griel truck driven by Stewart and was using the truck with the permission of truck owner Griel, and Stewart was injured in the loading process. It appears conceded that if the writer was gratuitously assisting and was injured while the truck was being loaded, Fireman's Fund policy would be primary.

That the loading and unloading clause is a phrase of expansion of coverage seems to be universally agreed (Pacific Automobile Insurance Co. v. Commercial Casualty Co., 108 Utah 500, 161 P.2d 423, 160 A.L.R. 1259, 1945). It is the position of the appellees and plaintiffs, of course, that the exclusion applies only if, for example, Stewart

sued his employer Griel, or a co-employee. The Work-men's Compensation exclusion also eliminates coverage in that instance.

There also seems no question or contention by Fireman's Fund that if the trial court is sustained, the truck policy of Fireman's is primary. (Maryland Casualty Co. v. Tighe, 115 F.2d 297, 9th CA, 1940; State ex rel Butte Brewing Co. v. District Court, 110 Mont. 250, 100 P.2d 932, 1940, Annotation 160 A.L.R. 1259. We call particular attention to Pepsi-Cola Bottling Co. of Charleston v. Indemnity Insurance Company of North America, 318 F.2d 714, 4th CA, 1963, which the appellees now quote with appropriate italicized insertions of the parties involved in this appeal):

"Concededly, able authority supports the opposite view (appellant's view). E. G., Kelly v. State Auto Ins. Ass'n, 288 F.2d 734 (6 Cir., 1961); American Fid. & Cs. Co. v. St. Paul-Mercury Indemn. Co., 248 F.2d 509 (5 Cir., 1957). Equally reputable precedents, however, hold the insurer (Fireman's Fund) obligated to respond to a claim made against one insured by a person not in its employ but in the employ of another insured (Walker) under the same policy. Gulf Ins. Co. v. Mack Warehouse Corp., 212 F.Supp. 39 (E.D. Pa. 1962); General Aviation Supply Co. v. Insurance Co. of N. America, 181 F.Supp. 380 (E.D. Mo.), aff'd, 283 F.2d 590 (8 Cir., 1960); Ginder v. Harleysville Mut. Cas. Co., 49 F.Supp. 745 (E.D. Pa. 1942)2, aff'd, 135 F.2d 215 (3 Cir., 1943). See Annot., 50 A.L.R. 2d 78, 97 (1956). Unfortunately for us the Supreme Court of West Virginia has not considered the question. Judge Parker writing for this court left it open, but with a strong implication of agreement with the conclusion we have here expressed, in Lumber Mutual Casualty Ins. Co. v. Stukes, 164 F.2d 571,

574. (4 Cir., 1947). In the same direction, although not squarely apposite fact-wise, is the decision of the late Judge Ben Moore of the Southern District of West Virginia, in Farm Bureau Mut. Auto. Ins. Co. v. Smoot, 95 F.Supp. 600, 603 (1950).

This construction accords with the rudimentary rule of interpretation that the court should ferret out and pursue the intent and purpose of the policy. No reason is shown why an insured should not be indemnified against a claim of one outside that (Griel) insured's employment. Again, admittedly, one of the objects of the exclusion is to avoid duplication of coverage with employee compensation insurance. Moreover, the hornbook requirement is apt, that the policy wherever ambiguous should be read against its scrivener. Here Indemnity (Fireman's Fund) could readily have unequivocally excluded the coverage now resting upon it. General Aviation Supply Co. v. Insurance Co. of N. America, supra, 181 F.Supp. 380. 384. The omission implies an intent not to seek such an exemption.

Strongly persuasive, if not conclusive, of the soundness of the District Judge's holding is the policy's Severability of Interests clause:

'The term "the insured" is used severally and not collectively, but the inclusion herein of more than one insured shall not operate to increase the limits of the company's liability.'

This provision compels consideration of each insured separately, independently of every other insured. Its effect here is to segregate Elk (*Griel* and *Fireman's Fund*) and Pepsi (*Walker*) in the ascertainment of the coverage of each. In this isolation the reference to an employee of an insured designates solely that insured who is his employer. It does not allow such employment to be attributed to another insured who

in truth is not the employer. Gulf Ins. Co. v. Mack Warehouse Corp., supra, 212 F.Supp. 39, 43; General Aviation Supply Co. v. Insurance Co. of N. America, supra, 181 F.Supp. 380.

But regardless of the two-fold protection of Pepsi by both Indemnity and Travelers, *primary* coverage was placed on Indemnity (*Fireman's Fund*) by the District Court under the Other Insurance clause of Travelers' policy. That section provides:

'Other Insurance. If the insured has other insurance * * * the insurance under this policy with respect to loss arising out of * * * the use of any non-owned automobile shall be excess insurance over any other valid and collectible insurance.' (accent added)

The governance here of this provision is perfectly manifest. The decisions are almost unanimous in according such efficacy to the clause. American Surety Co. of N.Y. v. Canal Ins. Co., 258 F.2d 934, 936 (4 Cir., 1958) (and cases there cited). Travelers' (Hartford's) policy cannot be enforced against its terms, and, therefore, neither Indemnity (Fireman's Fund) nor Pepsi (Walker) can impress upon it any liability before exhaustion of the other policy."

To buttress further the intent of the insurance industry itself, we quote from an authoritative article by Norman E. Risjord, Vice-President and General Counsel of the Employers Re-insurance Company of Kansas City, Missouri, writing in 29 Insurance Counsel Journal, 197 at pages 207, 208, in 1962:

"You will remember that there were many cases holding or assuming that the employee exclusion in the automobile policy applies only where the injured is an employee of the person claiming coverage. That was and is my position, partly because I happen to know that was the underwriting intent and it pains me to see the companies even raise (in this appeal, Fireman's Fund) say nothing of prevail with, the defense that the words "the insured" in the employee exclusion means any insured, so that no insured has coverage for injury to an employee of any person who is or might be under the policy."

In the same insurance industry journal at page 215, Risjord declared the guiding principles of the Combined Claims Committee of July 21, 1958, and the Pacific Claims Executive Committee at a meeting October 23-24, 1961, in Monterey, California, generally agreed as follows:

"That where a vehicle is being loaded or unloaded at a customer's premises and a member of the public or (you will especially notice) the driver is injured by reason of the negligent acts of the employees of the customer (this would be Danny Walker, Charles Walker's employee) engaged in the loading or unloading, the loss should fall upon the automobile insurer."

The loading and unloading provision of the automobile liability insurance policy was the subject of a monograph prepared by the Defense Research Institute, Inc., of Milwaukee, in April, 1965. We assume the court will take judicial notice that this Institute has most of the companies in the insurance liability field as members.

On page fourteen of the mentioned monograph, we find this language written by Edward C. German, a Philadelphia lawyer, Director of the Defense Research Institute and Secretary-Treasurer of the Federation of Insurance Council.

"Further, the courts which hold that the employee and co-employee exclusions apply if a person is an employee of any of the insureds have either not understood or have ignored the 'severability of interests clause' in the insurance policy. That clause reads: 'The term "Insured" is used severally and not collectively, but inclusion herein of more than one insured shall not operate to increase the limits of the company's liability.' The 'severability of interests clause' fundamentally and essentially is an explicit statement of what the courts have said was implicit meaning of the word 'insured.' The courts which have said that they must look to the person seeking coverage in construing the exclusion, have held that the addition of the 'severability of interests clause' indicate that the drafters of the policy, by the addition of such clause, intended to define the word 'insured' as only the person claiming coverage."

Mr. German then cites these cases:

"City of Albany v. Standard Accident Insurance Co., 7 N.Y.2d 422, 165 N.E.2d 869; Insurance Company of North America v. General Aviation Supply Co., 283 F.2d 590, Second Circuit, 1960; Kern v. Security Insurance Co., 195 F.S. 562, Arkansas, 1961."

Thus, this Philadelphia lawyer, writing for a defense organization, agrees completely with the position of Walker and Hartford here.

Further, Mr. German writes at page twelve of the April 1965 Bulletin, that:

"An increasing number of the courts have construed the exclusion strictly against the insurer and have held that an employee of an insured, other than the insured who invokes the coverage of the policy, is not within the language of the employee exclusion." This is directly contrary to the statement of appellant's counsel that:

"It is believed that this latter fact clearly discloses the modern trend is strictly adverse to Hartford's position herein." (page 7, Brief)

We submit this statement is in error both as to the trend and the inference that Hartford is the only true appellee. The court will note that the declaratory judgment complaint was verified by Charles Walker on September 14, 1966. It will further note that the suit of Stewart against appellee Walker sought \$172,000.00 in damages. As a matter of fact, limits of liability of Walker's Hartford policy was only \$25,000.00 and he definitely was in an exposed position of personal liability.

It is to be noted that Trial Judge Smith considered the Insurance Counsel Journal article and cites it as Note 7 at page 901 of 268 F.Supp.

A very thorough 1966 Florida decision, Shelby Mutual Insurance Co. v. Schuitema, 183 So.2d 571 at 573, is squarely in point. We quote at length so that the Court will be fully informed of the reason of this addition (severability of interests) to automobile policies with loading and unloading coverage after 1955:

"Under the standard automobile policy in use before 1955 there was a split of authority as to whether coverage was provided under facts similar to the instant case. See Annot., 50 A.L.R. 2d 99. In 1955 the insurance underwriters attempted to eliminate the confusion of interpretation then existing by adding the 'severability of interests' clause here involved. It appears to be the virtually unanimous opinion of

the legal scholars writing on the subject that the purpose of the addition of the severability of interests clause was to provide coverage under the facts in the instant case. Risjord & Austin, 'Who is the "Insured", Revisited, 28 Ins. Counsel J. 100 (1961): Thomas, The New Standard Automobile Policy; Other Provisions, 393 Ins. L. J. 653 (1955): Brown & Risjord, Loading and Unloading, The Conflict Between Fortuitous Adversaries, 29 Ins. Counsel J. 197 (1962); Breen, The New Automobile Policy, 388 Ins. L. J. 328 (1955). Since the adoption of the severability of interests clause in a policy which would or might apply to several insureds, the term 'the insured', as used in the exclusions and conditions of the policy, means only the person claiming coverage. Thus, for example, the exclusion for injury to an employee of 'the insured' deprives no one of coverage except with respect to his own employees. This is true because the term 'the insured' is used severally and not collectively. Risjord & Austin, Standard Family Automobile Policy, 411 Ins. L. J. 199. find ourselves unable to adopt a conclusion that the policy affords less coverage than that which the industry generally intended to provide. We believe the decisions to the contrary relied upon in the Liberty Mutual decision have followed the line of no coverage decisions existing before the adoption of the severability of interests clause, thereby in effect giving no meaning to the addition of this clause. This is apparent by a study of the decision principally relied upon, Transport Ins. Co. v. Standard Oil Co. of Texas, 1960, 161 Tex. 93, 337 S.W.2d 284. This decision was adopted four to three and was based in part on American Fidel. & Cas. Co. v. St. Paul-Mercury Indemn. Co., 5th Cir. 1957, 248 F.2d 509. The author of the latter decision, Judge Brown, later noted that in American Fidelity there was no severability of interests clause and that in his view where there was a severability of interests clause the result would be

necessarily different. See Brown's concurring opinion in American Agriculture Chemical Co. v. Tampa Armature Works, Inc., 5th Cir. 1963, 315 F.2d 856. We find ourselves unable to agree with the conclusion that the addition of the severability of interests clause would produce no change in the construction given to policies existing prior to the inclusion of that clause."

The Florida court also noted that it was apparent that the parties intended to furnish coverage to persons other than the named insured and that the effect of the severability of interests clause is to make it certain that, when a claim is asserted against one who is an insured under the policy, then that person becomes "the insured" for the purpose of determining the insurer's obligation with respect to that claim. The exclusion as to employees of the insured is thus limited and confined to the employees of the employer (here Charles Walker) against whom the claim is asserted. The forward recites the well-reasoned 4th Circuit case of 1963, Pepsi Cola Bottling Co. v. Indemnity Insurance Co., 318 F.2d 714 and Gulf Insurance Co. v. Mack Warehouse, Pa., 1962, 212 F.Supp. 39.

4. Distinguishing Appellant's Cases

The appellant cites certain cases in its Brief. Most of them can be readily distinguished from the insurance contract involved here. The page of the appellant's Brief is designated. Few of the following cases discusses the "severability of interests" present in Fireman's policy. As noted above, this was added in 1955 to clarify the underwriting intent and, as stated below, some of these acci-

dents occurred that year, 1955, or before.

Simpson v. American Automobile Insurance Company, 327 S.W.2d 519, Missouri, 1959, brief p. 12. The case arose out of an accident on April 28, 1955. It is distinguished in 181 F.S. 384, supra.

Fireman's Fund Indemnity Co. v. Mosaic Tile Co., 115 S.E.2d 263, Georgia, 1960, brief p. 14. The trial court there, incidentally, was for coverage. The accident date was November 29, 1955 and no cases adverse to appellant's position are even mentioned.

General Accident Fire and Life Assurance Corporation, et al v. Ray Brown, 181 N.E.2d 191, Illinois, 1962, brief p. 15. The Illinois court found there was no proof the injured party was using the insured truck at the time he was injured and hence discussion about who is "the insured" appears to be unnecessary. In the discussion they rely on the Seventh Circuit decision of Michigan Mutual Liability Co. v. Continental Casualty Co., 297 F.2d 208. This decision does not discuss the severability of interests clause. Ohio Casualty Insurance Company v. U.S.F. & G., 223 N.E.2d 851, Illinois, 1967, simply cannot be justified, in our view. Page 27, brief.

Birenkott v. McManamay, 276 N.W. 725, South Dakota, 1937, brief p. 15. This case is clearly not in point. The injured party was injured in the course and scope of his employment and sued his employer, the insured. The exclusion of an employee suing the named insured, his employer, was upheld. We have no quarrel with this.

Benton v. Canal Insurance Company, 130 So.2d 840, Mississippi, 1961, brief p. 18. This case is adverse to the appellees but relies on the Texas case of Transport Insurance Company v. Standard Oil, 337 S.W.2d 284. And, as we have previously noted, three Texas judges dissented and pointed out the majority did not cite one case which contained the severability of interests addition of 1955.

Michigan Mutual Liability Co. v. Carroll, 123 So.2d, 920, Alabama, 1960, brief p. 21. Severability was not discussed in this case which involved a November 24, 1955 injury. The Alabama case does note that the Ninth Circuit decision of Kaifer v. Georgia Casualty Co., 67 F.2d 309 is adverse to their holding.

Connelly v. London and Lanchire Indemnity Co., 28 At.2d 753, Rhode Island, 1942, Brief p. 21. The case is not in point. There a chauffeur of the insured wrecked the car, killing two maids of the named insured who were with him. The court found the maids were not in the course and scope of their employment at the time and hence the auto carrier afforded coverage.

State Farm Mutual Insurance Co. v. Employers Fire Insurance Co., 123 S.E.2d 108, North Carolina, 1961, brief p. 22. Severability was not discussed and the fact situation was that the employee of a named insured sued the omnibus insured operating the employer's car. It was held that the employees of a named insured cannot recover from the carrier of the named insured.

Auto Racing, Inc. v. Continental Casualty Company, 304 F.2d 697, CA, Oklahoma, 1962, Brief p. 20. The Tenth

Circuit very carefully points out that the case before it, excluding from coverage all persons employed on or about a fairground, was to be distinguished from the fact situations presented in *Kaifer v. Georgia Casualty Co., supra*, 9th CA, and *Cimarron Insurance Co.* v. *Travelers Insurance Co.*, supra, 355 P.2d 742. At page 698 of 304 F.2d the Tenth Circuit stated:

"The careful reading of the cases cited (such as Kaifer) to support this position (of coverage) convinces us that they are not applicable to our situation."

Associated Indemnity Corp. v. Wachsmith, 99 P.2d 420, Washington, 1940, Brief, p. 16. This case involved the September 17, 1935 occurrence, twenty years before the addition of the severability of interests. Furthermore, it is, as other cases the appellant has cited, a suit by the employee of the named insured against another employee of the named insured. This situation, of course, we do not have in this present appeal.

United States Fidelity & Guaranty Company v. Western Casualty and Surety Company, 408 P.2d 596, Kansas, 1965, Brief p. 17. The severability of interests addition of 1955 was not mentioned in this Kansas case. Appellant's counsel quotes that liberal construction does not apply in the dispute between two insurance companies.

As we have mentioned, the omnibus insured (Walker) at the time this declaratory judgment was filed, had a distinct interest in a ruling Fireman's Fund was primary coverage and his own carrier was excess.

Reliance is particularly placed on the case of American Fidelity and Casualty Co. v. St. Paul-Mercury Indemnity Company, 248 F.2d 509, 5th CA, 1957. See page 22, appellant's Brief.

Circuit Judge Brown is the Brown of Brown and Risjord who had a lengthy discussion in 29 Insurance Counsel Journal, beginning at page 197.

As noted by the Florida Shelby Mutual case, supra, this very Circuit Judge Brown in a 1963 decision in a concurring opinion discussing the "intent problem" of insurance policies, indicated the severability of interests addition in 1955 was of significance and that the St. Paul-Mercury decision (248 F.2d 509) upon which many courts relied and where there was no severability of interests, may have transmuted a cross-employee exclusion of an Alabama case into a "legendary white-horse case" which adopted his St. Paul-Mercury decision. (American Agricultural Chemical Co. v. Tampa Armature Works, 315 F.2d 856, 863, Note 9.)

Thus, with the 1955 severability of interests addition, we respectfully submit the so-called St. Paul-Mercury case, 248 F.2d 509, is not authority for appellant's position.

The Fourth Circuit is cited on page seven as sustaining appellant's position. The case cited is on page ten of appellant's brief, Lumbermen's Mutual Casualty Insurance Co. of New York v. Stukes, et al, 164 F.2d 571, 4th CA, South Carolina, 1947.

No mention was made of Pepsi-Cola Bottling Com-

pany of Charleston v. Indemnity Insurance Company of North America, supra, a 1963 decision, 318 F.2d 714 which we have quoted in length and directly sustains the position of Trial Judge Smith.

Attention is directed to a 1966 Fourth Circuit decision involving Maryland law which cited the *Pepsi-Cola* decision with approval. (*Travelers Insurance Company* v. *Employers Liability Assurance Corporation*, 367 F.2d 205 at 207.)

The Eighth Circuit case of Campbell v. American Farmers Mutual Insurance Co., 238 F.2d 284, CA Missouri, 1956, cited on page 21 of appellant's Brief is not in point. There the direct employee, a school teacher of the assured school district, sued the district. The point decided was that she was such an employee in the course and scope of her employment by the named insured at the time of the one-vehicle accident and the employee exclusion applied. We have no quarrel with this decision. Appellant does not mention a 1960 Missouri decision which, reviewing all the authorities and determining precisely the effect of the "severability of interests" provision, ruled as Trial Judge Smith did. (General Aviation Supply Company v. Insurance Company of North America, 181 F.S. 380, Mo., 1960, affirmed by the 8th Circuit, 283 F.2d 590.)

Appellants cite on page 21 of their brief Miller and Buchong, Inc. v. Travelers Insurance Company, 231 F.S. 128, Penn., 1964. The court in that case relied on a 1963 Pennsylvania decision in which the private automobile

carrier excluded from coverage any member of the family of the insured. A son of the insured, as a passenger, was injured when another party was driving the car with permission of the father of the injured boy. There was no mention of the severability clause, no citing of authorities to the contrary, and the court simply projected what it assumed would be the Pennsylvania rule.

We suggest the Eighth Circuit case of Farmers Elevator Mutual Insurance Co. v. Austad & Sons, Inc., 366 F.2d 555, CA North Dakota, 1966, can be distinguished. The case is mentioned on page 27 of appellant's Brief. The basic holding was that the omnibus insured was not "using" the insured truck at the time of the accident. The court then said the district judge stated a "permissible conclusion" although it appears the conclusion was not necessary, that the North Dakota Court might have held the exclusion clause applies to suits by an employee of the named insured against anyone. There is no discussion of the effects on severability of interests clause or whether such a clause was in the truck policy. Furthermore, the decision of Fifth Circuit Judge Brown (no severability provision present) in which the phrase "fortuitous adversaries" is first used, is relied upon. (Note 2, page 557 of 366 F.2d, 8th CA, North Dakota)

As discussed above in the intent of the coverage, loading and unloading was an extension of coverage, it was intended to increase the coverage of the truck policy during the loading and unloading process as long as the truck was being utilized. This is the precise situation we

have in this appeal by Walker.

At page 22 appellant relies upon the Ohio case of American Fidelity & Casualty Co. v. Indemnity Insurance Company of North America, 195 F.S. 641, Ohio, 1961, affirmed 308 F.2d 697, 1962. The District Court decision involved a January 29, 1959 injury and there was no discussion or mention of the severability of interests clause. There was also no reported Ohio case in point and a trial court judge felt obliged to follow previous Sixth Circuit decisions.

However, the Ohio Court of Appeals in a case three years later, 1964, Travelers Insurance Company v. Auto-Owners (Mutual) Insurance Company, 1 Ohio Appeals 2d 65, 203 N.E.2d 846, while noting the Sixth Circuit decisions, took exception and said the Ohio law was contrary and the employee of the omnibus insured was protected by the vehicle policy when the employee of the named insured sued the omnibus insured.

The Ohio court flatly stated that what it called "the minority view," namely sustaining the position of the appellant here, is apparently followed in about four states, citing Florida, Mississippi, Washington and Texas. (Travelers Insurance Co. v. Auto-Owners (Mutual) Insurance Co., 203 N.E.2d 846 at 849) The Ohio case is squarely in point and after noting that the minority view in the Sixth Circuit Court decisions are in effect re-drafting the insurance policies, they pose this question. Again we will interpolate the parties to this present appeal where applicable.

"In considering this exclusion clause, it is again important to simply reverse the position of the parties as was done above in discussing the general exclusion clause. In the present case it was the employee .(Stewart) of the named insured (Griel) who was injured by an additional or omnibus insured. (Danny and Charles Walker) In the exact reverse situation an additional or omnibus insured (Danny Walker) is injured by the named insured (Griel) or its employee, i.e., Randolph's employee (Stewart) injures a Goodwill (Walker) employee. Obviously this would lead to a suit against the named insured (Griel). Under the wording of the employee exclusion clause, here the one fits just as tightly as the other! Again, the result of appellant's interpretation and that of the minority view is a substantial loss of coverage to the named insured (Griel) with respect to the very liability for which it purchased protection."

After noting the Federal Court would be bound to follow the law of the particular state involved, Ohio declared:

"The weight of authority clearly holds that the separability of multiple insureds applies equally well to the employee-exclusion clause." (Page 849 of 203 N.E.2d 846)

The 1964 Ohio decision is cited for the position of the plaintiffs-appellees in this present appeal by the Eighth Circuit in Farmers Elevator Mutual Insurance Co. v. Austad, 366 F.2d 555, 558, 1966.

In a decision of the Sixth Circuit decided just this June involving a cross-employee exclusion clause (not in issue in this present Walker appeal) the Sixth Circuit noted that the Auto-Owners (Mutual) Insurance Company case, supra, is still the law of Ohio. (Allstate Insurance

Company v. Hill, 378 F.2d 112 at 115, Ohio, CA 1967)

Yet another case cited by the appellant on page 22 of his brief is clearly distinguishable. In American Fidelity Co. v. Deerfield Valley Grain Co., 43 F.S. 841, Vermont, 1942, all that was involved was an employee directly suing his employer and co-employees for injury arising out of the course and scope of his employment. The court held the employee-exclusion clause applied; there was no mention of loading and unloading or omnibus insured questions or severability as they were irrevelant.

Again on page 22 of the Brief another Sixth Circuit case is cited, Maryland Casualty Company v. American Fidelity & Casualty Company, 330 F.2d 526, an April, 1964 decision involving Tennessee law.

The Sixth Circuit noted that the district judge expressed the opinion that if the issue (omnibus insured being sued by named insured's employee) was an open one in Tennessee, he would rule that the employee-exclusion clause did not deny coverage to the omnibus insured under the defendant's policy. The Circuit went on to say that the district judge felt constrained under decisions of the Sixth Circuit in the Ohio Travelers Insurance case (262 F.2d 132) and the Kelly case (288 F.2d 734) to rule coverage did not exist for the omnibus insured. The 1964 Maryland Casualty decision noted that only the laws of two states had been construed by it, there being no state decisions on the subject, and one was Ohio. As observed above, Ohio in 1964 disagreed with the Sixth Circuit in Travelers Insurance Company, 203 N.E.2d 846.

As a matter of fact, the District Judge in Tennessee at page 690 of 217 F.S. collects the cases in footnote 1 holding there is coverage, such as plaintiffs and appellees here urge, citing cases from California, Indiana, Louisiana, Minnesota, Missouri, New Jersey, New York, Ohio, Oregon and the Fifth Circuit. We have difficulty comprehending the appellant's statement that the clear weight of authority and the trend favors the appellant's position.

District Judge Wilson at page 691 of 217 F.S. (as did Trial Judge Smith) after noting the authorities, observed:

"From the foregoing, is it not clear that the only thing that can be said with certainty is that an ambiguity exists with regard to the meaning of the phrase 'the insured' as used in exclusion (d) and (e)? This conclusion would seem inescapable from the mere fact there are so many conflicting opinions in the cases themselves as to what this policy language means."

Actually, there need not be this confusion in our view. Certainly the insurance industry has been quite aware of this problem and the Tennessee District Judge in 217 F.S. 688 wondered why the language was not changed. Certainly it would be very simple to say, if such was the intent rather than to expand the coverage under loading and unloading, to exclude coverage for the "employee of the named insured or omnibus insured?" This they did not do and as Risjord noted above, they didn't intend to. The answer is just that simple.

As a Minnesota Federal Judge wrote in 1966:

"In answer to the possible argument that the latest Minnesota cases expanding the scope of coverage under 'loading-unloading' clauses were unknown to defendant when the contract was drawn, the fact remains that the failure to adopt restrictive language, in light of the numerous decisions in all jurisdictions construing these clauses, and the lack of a clear position under Minnesota law, weighs most heavily against any hindsight contention by defendant (vehicle carrier) that it intended anything but the broadest scope the law allows to such unrestrictive language." (Johnson, Drake & Piper, Inc. v. Liberty Mutual Insurance Co., 258 F.S. 603 at 610, Minn. 1966)

The appellees would be closing their eyes not to recognize there are a few jurisdictions (certainly not the great weight of authority or the like) which have misconstrued what was meant seemingly because it struck them this was a risk to which a fellow in the place of appellee Charles Walker should not benefit. Simply assume Charles Walker was not insured as we suppose often is the case in a loading and unloading situation. The injured employee of the named insured would have no recourse, except Workmen's Compensation. This Trial Judge Smith recognized in Footnote 11, page 902 of 268 F.S. quoted above:

"Here the insured Walker is not concerned because his comprehensive policy with Hartford would cover the loss, but the effect of this decision is to increase Walker's coverage to extend protection to those in Walker's position who are not otherwise covered. For that reason interpretation here reached does favor the insured."

A well-reasoned case collecting the authorities to

1960 sustaining appellee's position here is General Aviation Supply Co. v. Insurance Company of North America, 181 F.S. 380, Missouri, 1960. The decision was affirmed at 283 F.2d 590, 8th CA.

The Missouri Federal Court had squarely before it the effect of the severability clause and declared the employee's exclusion should be limited and confined to the employees of the employer who seek the protection. (181 F.S. page 384) The Court further stated, citing Kaifer v. Georgia Casualty Co., 67 F.2d 309, 9th CA, 1933, that:

"In setting forth exclusions there is no apparent reason why the insurance carrier (Fireman's Fund) cannot be specific and clear in its designations."

As this court is undoubtedly aware, the Kaifer case, supra, is universally cited for the rule urged by the appellees; namely, if the omnibus insured is not the employer of the insured person nor an employee of the named insured, the auto policy is responsible. (e.g. 50 A.L.R.2d page 97, and see 1963 Proceedings of American Bar Association Section of Insurance, Negligence and Compensation Law, page 117)

An exhaustive discussion sustaining the position of the appellees here is Cimarron Insurance Co. v. Travelers Insurance Co., Oregon 1960, 355 P.2d 742. The decision observes "the insured" is ambiguous (page 750 of 355 P.2d) and this must be construed against the insurer in the position of Fireman's Fund. Trial Judge Smith noted the Cimarron case and concluded it would be persuasive with Montana (Note 10, page 901 of 268 F.S.) We refer

the Court to a more or less pioneering decision of Montana, State ex rel Butte Brewing Co. v. District Court, 110 Mont. 250, 100 P.2d 932, 1940, for the approach the Montana Court takes. This state is committed to the "completed operations" rule in loading and unloading, which is and would be an extension of coverage. The appellees have every confidence if the question involved in this appeal were put to the Montana Court, the appellees would prevail.

5. Omnibus Coverage Protects Employee of Omnibus Insured

The following discussion was not commented upon by the trial judge but furnishes a substantial reason for reaching the result of Trial Judge Smith and, we submit the intention of the insurance industry.

The Ninth Circuit furnishes the reason.

The general rule is that if an employee (here Danny Walker) is negligent, then the employer (Charles Walker) who is responsible because of respondent superior, may recover from the employee any loss. (Pacific Employers Insurance Co. v. Hartford Accident & Indemnity Co., 228 F.2d 365, 370, 9th CA, 1955.)

Further, that the carrier paying this vicarious obligation is subrogated to the recovery right against the negligent employee. This would be Hartford against Danny Walker. (Pacific Employers Insurance Co., supra, 228 F.2d 365 at 370 and 371. See also Canadian Indemnity Co. v. United States Fidelity & Guaranty Co., 213 F.2d

658, 9th CA, 1954.)

The Eighth Circuit, quoting from Travelers Insurance Co. v. General Casualty Co., 187 F.S. 234 at 236, Idaho, 1960, a loading and unloading case sustaining the appellees, said:

"The reason for this rule is obvious. It prevents multiplicity of suits and holds the insurer liable (Fireman's Fund) who by a circuity of actions would eventually be obligated to pay any judgment rendered against the employer resulting from the negligence of his employee." (Pacific National Insurance Co. v. Transport Insurance Co., 341 F.2d 514, 518, 8th CA, 1965)

In this case then, Danny Walker would be liable to his employer, appellee Charles Walker for Danny's alleged negligence. It is Danny Walker, as well as Charles Walker, who are insured by loading the logging truck with permission. Obviously, Hartford had no agreement to indemnify Danny Walker, if his employer claimed against him for any judgment or compromise. Thus, the loss falls precisely where intended, back to Fireman's Fund who have agreed to accept Danny Walker as an omnibus insured while utilizing the logging truck they insure.

6. Montana State District Court Decision

On pages 27-30, the appellant calls the attention of the court to a Cascade County, Montana decision, now on appeal to the Montana Supreme Court, *Travelers Insur*ance Company v. American Casualty Company, et al.

The Cascade County case is assigned number 66532-C in that Court. Counsel for appellees here did not appear.

The July 12, 1967 opinion involves certain facts which are dissimilar to this appeal by Fireman's Fund. Garbage cans were claimed to be negligently loaded with heavy combustible material, contrary to a Great Falls ordinance, by the Travelers' insured. One issue was whether the Travelers' insured should have known such a heavily loaded container might injure a person attempting to lift the same. It was found as a fact that this negligence occurred prior to the actual loading of the truck. Therefore, the Travelers' insured was not using the truck and hence was not an omnibus insured at the time of the incident injuring one Cort.

The State District Court did not set forth any authority for its conclusion that the American Casualty policy was not "ambiguous" nor "is it made ambiguous by severability of interests clause". (See Conclusion II of Exhibit "A" to appellant's motion, p. 30, Brief.) Appellees submit such a conclusion is contrary to authority and reason. If it rules on the point, the Montana Supreme Court will reverse this conclusion. This may be done for two reasons:

- (1) Assume the American Casualty policy is not ambiguous... The clear intent of the insurance industry as discussed above is that the omnibus insured is covered by the truck policy during the loading process if sued by employee of named insured. The State Judge was in error in construing the policy.
- (2) If ambiguous, then the rule of the clear weight of authority would require strict construction against American Casualty.

This Cascade County case should not give this Court pause and this present appeal should be heard and argued as the calendar of the Court permits, and decision rendered in normal order. As appellant states on page 30 of his brief, this Court of Appeals is not bound by the decision of a county state court.

CONCLUSION

Appellees Walker and Hartford trust this Court does not take the view they "protesteth too much", but valid protest appeared necessary.

As suggested, this brief could well have terminated after the short discussion regarding the fact finding of ambiguity by the trial judge in the appellant's truck policy. A short judgment adopting Trial Judge Smith's Findings and Conclusions as reported in 268 F.S. 899, page 82, Transcript, is all that is required.

However, Walker and Hartford sincerely believe it has been shown, particularly since the 1955 addition of the "severability of interests" provision, that the insurance industry, including Fireman's Fund, intended to protect the omnibus insured when sued by an employee of the named insured in an occurrence arising out of the loading or unloading of the insured truck. The clear, correct and overwhelming weight of authority, both judicial and the insurance experts, so declare.

We respectfully request this Court to decide the sole issue presented by the appellant (the effect of the em-

ployee-exclusion clause) firmly in favor of the appellees for the following reasons:

- (1) The insurance intent of the truck policy of Fireman's Fund was to insure Charles Walker and his employee in the fact situation arising out of the accident and subsequent State action by Stewart against Charles Walker, and this as primary insurer.
- (2) The Trial Judge found as a fact that the Fireman's policy is ambiguous. Montana law is, as is basic insurance law, that ambiguity is to be construed against the carrier, Fireman's Fund. We remind the Court again of the personal exposure of appellee Walker which is the \$172,000.00 tort action in State Court initiated by Stewart. Upholding the trial court would have the further result (and we submit, intended result) of affording beneficiary Stewart further protection as the Hartford policy would be available as excess coverage, in this instance.
- (3) Although not necessary to the decision here, circuity of action would be avoided, as discussed in Section 7, supra.

Respectfully submitted this ______day of December, 1967.

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Ry

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Attorneys for Plaintiffs-Appellees

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

H. L. Holt, Attorney

I certify that I served the above Brief upon the defendant and respondent in the above entitled action on the day of December, 1967, by mailing a copy of said Brief by first class mail, postage prepaid, to Keller, Magnuson & Reynolds, South Annex Power Block, Helena, Montana 59601.

MIBUD

H. L. Holt, Attorney



No. 22132

IN THE

United States Court of Appeals

For the Ninth Circuit

FIREMAN'S FUND INSURANCE COMPANY,

Appellant,

vs.

CHARLES WALKER and HARTFORD ACCIDENT AND INDEMNITY COMPANY, Appellees.

Reply Brief of Appellant FIREMAN'S FUND INSURANCE COMPANY

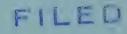
On Appeal from the United States District Court for the District of Montana

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IN THE

United States Court of Appeals

For the Ninth Circuit

vs.

CHARLES WALKER and HARTFORD ACCIDENT AND INDEMNITY COMPANY, Appellees.

Reply Brief of Appellant FIREMAN'S FUND INSURANCE COMPANY

On Appeal from the United States District Court for the District of Montana

We shall attempt to keep in mind herein the proper office of the Reply Brief, namely, rebuttal and therefore, and in the interests of simplicity and ease of review of this brief, shall attempt to chronologically answer or comment upon the brief of the appellees in the same order as set out in the appellees' brief.

Commencing on page 3 of the Appellees' brief under the heading "Effect of Trial Judge's Findings and Conclusions" Appellees state in part as follows:

"It is to be recalled now that District Judge Smith found as a fact that the *policy* was ambiguous, pointing out the conflict of appellate decisions. * * *." (Emphasis supplied).

This quotation is erroneous. What Judge Smith found as a fact (assuming the issue of one of fact and not of law, which assumption is questionable) was that the *policy* was *not* ambiguous but rather arrived at his conclusions solely because of the fact that there was a conflict of decisions in other jurisdiction. It is that latter reasoning which we believe to be an erroneous approach on Judge Smith's part. The only thing that Judge Smith found as a fact was that the policy was not ambiguous and he repeatedly so stated in his findings.

Under this same heading Appellees apparently contend, or at least infer, that once a Federal District Court has made a decision on this specific issue that the Circuit Court is powerless to reverse the same even if the appellate court does not agree. Obviously this is not the law. If further argument on this issue is needed, this court's attention is respectfully invited to the three following Circuit Court cases, cited in the Appellants' original brief, all of which reversed a District Court holding on this precise point. These cases are:

United States Fidelity and Guaranty Co. v. Amer-

ican Fidelity and Casualty Co., 299 F.2d 215 (1962) (7th Circuit);

Lumber Mutual Casualty Ins. Co. of New York v. Stukes, et al, 164 F.2d 571 (1947) (4th Circuit);

American Fidelity and Casualty Co. v. St. Paul-Mercury Indemnity Company, 248 F.2d 509 (1957) (5th Circuit) (This case is generally considered to be the leading case on this point).

Commencing on page 5, of Appellees' brief, they set out certain law under the heading of "Montana Insurance Principles." We have no quarrel with the law therein contained. The only comment we feel is desirable under this heading is the fact that this is actually a controversy between two insurance companies and thus the rule of liberality of construction or of strict construction against the policy writer is not applicable since there is no insured which would be left without coverage, as stated in United States Fidelity and Surety Company v. Western Casualty Company, 408 P.2d 596 (Kan.) (1965):

"We find no ambiguity in the language used. We should not seek ambiguity where none exists merely for the purpose of invoking the rule of liberal construction.

"In a case involving a dispute between two insurance companies we do not have occasion to apply the rule of liberal or extended interpretation which is sometimes necessary to protect a

layman in the coverage which he thought he was receiving." (Emphasis supplied).

And as stated in the Montana statutory Maxims of Jurisprudence, Sec. 49-102, R.C.M. 1947:

"49-102. (8739) When the reason of a rule ceases, so should the rule itself."

Appellees appear to place great weight on the personal opinion of Norman E. Risjord particularly in reference to an article appearing in 29 Insurance Counsel Journal starting at page 197 (April, 1962). It would thus behoove us to inquire as to the nature of this article and the identity and background of its author, although we hasten to say that we in no way challenge the sincerity or integrity of that author.

Who is Norman E. Risjord? Mr. Risjord is a Vice-President and General Counsel of Employers Reinsurance Corporation of Kansas City, Missouri. The undersigned was so struck with Mr. Risjord's enthusiasm and perhaps even ferocity in advancing the position that Risjord takes, that a check was made with the office of the Montana Insurance Commissioner to determine, if possible, what kind of insurance that Mr. Risjord's company wrote. He was informed that, in Montana, Employers Reinsurance Corporation was licensed to write directly and does write directly various kinds of liability insurance except AUTOMO-BILE LIABILITY INSURANCE and WORKMEN'S

COMPENSATION INSURANCE. Assuming that this company does not write automobile liability insurance in other states also (which the writer does not know and has been unable to ascertain, but which appears to be a fair assumption since it is true in Montana) it is hardly shocking to the undersigned, and we trust to this Court, that Mr. Risjord should take the position that he does since such an interpretation obviously could never be adverse to any of his company's policies. It is felt that the foregoing is all the comment which we wish to offer in reference to this Insurance Counsel Journal article.

Commencing on page 15 of their brief, under the heading, "Distinguishing Appellant's Cases", we are satisfied that this Court will concur with the Appellant in its contention that each one of these cases which were cited by the Appellant unequivocally support the Appellant's position. The purported "Distinguishing" is completely and totally non-existent, with a possible exception of the "severability of interest" clause, which clause will be commented on at greater length hereafter. Again we shall establish that the great majority of cases which involve this specific issue have held that this clause makes no change in nor has any effect upon the involved employee exclusion clause.

On page 23 of their brief, Appellees quote from

Travelers Ins. Co. v. Auto-Owners Ins. Co., 203 N.E. 2d 846 wherein that lower state court (Franklin County, Ohio) stated that the weight of authority was balanced in favor of the position herein taken by the Appellees. This writer is utterly astounded as to why the court so stated. It is further extremely mystifying that that court goes on to state that there are only four states which have held to the contrary. As established in our original brief there appears to be at least 25 various jurisdictions, either State or Federal, which support our position herein. Many courts have expressly recognized that the weight of authority clearly predominates in favor of the Appellant.

In 1960 in Transport Insurance Company v. Standard Oil Company of Texas, 337 S.W.2d 284, at page 288, the court spoke as follows:

"The exact question involved is one of first impression in this jurisdiction. There is a split of authority in other jurisdictions, but the *weight* of authority is that if the injured party is the employee of any person who is insured under the policy, the employee exclusion is applicable although he may not have been an employee of the person committing the tort. * * *." (Emphasis supplied).

Again in 1960 in Buhonick v. American Fidelity & Casualty Company, 190 F.Supp. 399, at page 401, Federal Court spoke as follows:

"In spite of the conflict of authorities which exist from other states, I am satisfied that the weight and best reasoned authorities hold to the view that the exclusion provision applies to employees of an additional assured as well as to those of the named assured." (Emphasis supplied).

And this situation has not changed. In 1965 the Kansas Court in United States Fidelity and Surety Company v. Western Casualty and Surety Company, 408 P.2d 596, at page 598, reiterated the same using the following language:

"The exact question involved is one of first impression in this jurisdiction. There is divided authority in other jurisdictions but the great weight of authority appears to be in harmony with the views expressed herein. * * *." (Emphasis supplied).

It should further be noted that 18 of the 26 cases which we contend support our position herein were decided this decade. In view of the foregoing it appears that this answers the Appellees' question or comment found on page 25 of their brief which reads:

"We have difficulty comprehending the Appellant's statement that the clear weight of authority and the trend favors the Appellant's position."

We will now concern ourselves with the Appellees' contention to the effect that the addition in 1955 of the "Severability of Interest" clause supports their

position herein. Actually precisely the opposite is tru and again the great weight of authority so holds.

Transport Insurance Co. v. Standard Oil Co. o Texas, 337 S.W.2d 284 (290).

"We have concluded that the 'severability of interests' clause in the present policy cannot alter the holdings in the cases relied upon by Transport. * * *.

"In the policy involved here there is no ambiguity in the exclusion clauses and no inconsistency is shown between the exclusionar clauses and the 'severability of interests' claus in the policy. The clear and unambiguous term of the policy leads us to hold that no employee of the named insured engaged in the named in sured's business can recover on the named in sured's policy against anyone included as an additional insured. * * *."

Hanover Ins. Co., et al., v. The Travelers Indemnity Company, 318 F.2d 306 (1963), at page 311:

"With the authorities in this array and wit the Texas Supreme Court opinion then available the district court in the present case conclude that Judge Weber's decision was not controlling We agree with Judge Harper in this conclusion We suspect that Simpson, despite the absence there of the severability clause, affords a valiintimation as to what the Missouri courts wisay when the precise question here is eventuall presented to them." St. Paul Fire and Marine Insurance Company v. Wabash Fire and Casualty Insurance Company, 264 C.Supp. 637 (1967), at page 644:

"* * * The District Judge held that the presence of the 'severability of interest' clause did not alter the construction of the term 'the insured', and the Eighth Circuit affirmed."

(The court then goes on to rule that the employee xclusion clause was applicable and thus no coverge.)

Kelly v. State Automobile Insurance Association, 88 F.2d 734 (6th Circuit) (1961), at page 738:

"In our judgment, if it was intended by the severability of interests clause to provide coverage in a case like the present one, the language used was inadequate for that purpose. We can only enforce the policy as it was written."

Ohio Casualty Insurance Company v. United States idelity and Guaranty Company, 223 N.E.2d 851 Ill.) (1967), at page 854:

"Nor are we persuaded that the 'severability' clause creates any change or ambiguity in the interpretation of the exclusionary clause. There is no evidence as to the purpose of that clause, added in 1955 to standard policies, including that of both Plaintiffs' and Defendant's policies here. The clause was added presumably by the insurance industry and not a particular insurance com-

pany. If it were intended to avoid the conflict ir decisions, it could have been stated in clear language adequate to reconcile or avoid these conflicts. It was not so stated."

Benton v. Canal Insurance Company, 130 S.2d 840 (Miss.) (1961), at page 847:

"We think there is no ambiguity in the exclusion clauses of the Canal policy. We also think that the addition of the 'severability of interests' clause does not indicate that the drafters of the policy form by the addition of that clause intended that the words 'any employee of the insured', as they appear in the exclusion clauses, should mean 'any employee of the insured against whom liability is sought to be imposed.' We therefore hold, as the Court did in the Transport Insurance Company case, supra, that no employee of the named insured engaged in the named insured's business can recover on the named insured's policy against anyone included as an additional insured."

To the same effect please see State Farm Mutual Auto Ins. Co. v. Employers' Fire Ins. Co., 123 S.E.26 108 (N.C.) (1961) in which the opinion expressly noted that there was a severability of interest clause and held that the *exclusion* clause was applicable.

On page 27 of the Appellees' Brief, they refer to the Ninth Circuit case of Kaifer v. Georgia Casualty Co., 67 F.2d 309 (1933). While the Appellees make very little comment on the case, apparently inferentially recognizing that it is of little or no aid to them, nevertheless because it is a Ninth Circuit case and because we actually believe that, to the extent is relevant at all, it contains some strong dicta in support of our position, we would like to offer the following comments on the Kaifer case.

This case appears to be the earliest case (being approximately 35 years old) which is cited by any court is even purportedly interpreting or being of any aid in the interpretation of the question involved in the instant Declaratory Judgment action. It will be noted that the opinion is very short, cites no authority for its position, does not interpret policy provisions which are identical to the ones here involved and in some ways are not particularly similar; and THAT THE CACT SITUATION THEREIN WAS ENTIRELY DIFFERENT in that the case involved a fellow emloyee or cross-employee situation and not a premises wher.

We first would point out to this Court that, exclusive of any and all of the following arguments, the pinion in the Kaifer case indicates that had there een workmen's compensation coverage (as is true in the instant case) the result would have been the pposite. In this connection please note the following uotation found on page 310 of the Federal Reporter, with emphasis supplied by this writer:

"Literally construed the word 'assured' in this provision [meaning exclusion provision] would mean the named assured and the additional assured Sparks. Concededly plaintiff was not an employee of Columbia and Sparks jointly or of Sparks alone, but was in the sole employment of Columbia.

"The first exclusion clause *clearly* indicates that defendant assumed no liability to indemnify *either* Columbia or *anyone else* against loss arising out of an injury to any of *its* employees, which would be covered by a Workmen's Compensation Law. * * *"

While the opinion is silent on the matter the clear indication is that there was no workmen's compensation coverage involved.

In the Kaifer case the injured party was a fellow employee of the alleged tortfeasor, and both were employees of Columbia Pictures Corporation, the named insured. The injury apparently occurred on Columbia's premises. Thus it is seen the factual situation and the legal relationship involved in the Kaifer case are completely different than the situation here involved.

When the Kaifer case is analyzed it will be seen that actually its only holding (and no amout of arguing can change this) was that under the policy provisions there involved the exclusion was held not to apply in the case a fellow employee tortfeasor. If

that same Court had, at that time, the present policy before it, it would have necessarily held that there was no coverage. In this connection see Fireman's policy—Insuring Agreements—III Definition of Insured, subdivision (c) which states that the coverage here involved does not apply:

"to any employee with respect to injury to or sickness, disease or death of another employee of the same employer injured in the course of such employment in an accident arising out of the maintenance or use of an automobile in the business of such employer;"

This is conclusively established by the following language of the Kaifer opinion which reads as follows:

"If defendant had desired to exclude liability for any injury to any employee of Columbia caused by a fellow employee of Columbia, such exclusion would have been clearly expressed in the policy. * * *"

This limitation on the dicta or holding of the Kaifer case has been recognized in a number of cases. Illustrative of this is the recent Fourth Circuit case, (1966) of Bevans v. Liberty Mutual Insurance Company, 356 F.2d 577 wherein the Court spoke as follows with specific reference to the Kaifer case.

"As plaintiff correctly points out in his brief, an employer is exposed to two types of injury suits, one being internal from his employees and covered by workmen's compensation or other employer liability insurance, and the second being external involving third party injuries and protected by general liability insurance. However, plaintiff fails to appreciate that the insurer who is also a party to this contract is likewise exposed. to two possible fields of liability in insuring an employer and must compute its premiums accordingly. Were it to be liable in a situation such as that at bar it would have to increase its premiums and thereby require the employer to pay twice for protection against claims of employees: once under his employer liability policy and again under his general liability policy. As a result it became necessary to insert the employee exclusion, clause (d), in the policy in an attempt to divorce employee liability coverage from general public liability insurance. This approach failed, however in some jurisdictions [at this point the opinion cites only the Kaifer case] where the courts held the word 'insured' to include the party calling for insurance protection than restricting it to the named insured.

"Other jurisdictions limited the scope of the word 'employee' in the same clause to mean a person in the employ of the particular insured (named or additional) against whom the liability is being asserted and who is the party calling for coverage. Either way the result was the same. The insurer was confronted with greater liability than that for which he had contracted. What followed was the insertion of the fellow-employee exception [Para. III (a) (2)] in the omnibus clause so as to express the clear intent of the insurer to divorce completely employer liability

from general liability coverage. (Citing cases)" (Emphasis supplied)

See also Johnson v. Aetna Casualty and Surety Co., 104 F.2d 22, 5 Cir. Ga. 1939 in which the following is found:

"* * * Appellants rely on Kaifer v. Georgia Casualty Co., 9 Cir., 67 F.2d 309, but the policy there did not have clause (d) [fellow employee exception] just above discussed. That decision is further in opposition to such cases as (citing cases). * * *"

And in Lumber Mutual Casualty Ins. Co. v. Stukes, 164 F.2d 571 the Fourth Circuit expressly recognized this limitation of the holding of the Kaifer case to a fellow employee situation and that the Kaifer holding was instrumental in having the fellow employee exclusion clause added to standard policies. (pages 573 and 574 of the Federal Reporter)

The Johnson case, just quoted from, was later followed by Indemnity Insurance Co. of North America v. Malisfski, 46 F.Suppl. 454 1942, affirmed in 135 F.2d 910 (1943) (4th Cir.) (Md). The following quotation is from the Malisfski case:

"The case of Kaifer v. Georgia Casualty Co., referred to in the opinion in the Johnson case from which we have just quoted, is relied upon by counsel for Malisfski and the City. But we agree with the manner in which it was distin-

guished in the Johnson case—that is to say, the limitation clause with which we are here concerned was not in the policy in the Kaifer case. So we do not think that case is an authority contrary to our conclusions, but even if it were, we would not be disposed to follow it, because we believe the reasoning of the Johnson case to be the more sound." (Emphasis supplied)

As a matter of fact it appears that the fellow-employee clause (which is in Fireman's policy) was adopted by the insurance industry as a result of the Kaifer holding. This fact is noted in American Fidelity & Casualty Co., v. St. Paul-Mercury Indemnity Co., supra, on page 517 of 248 F.2d with the following language:

"Finally, St. Paul unavoidably commits itself to the curious argument that since, to avoid the result of Kaifer v. Georgia Casualty Company (citation) and others like it (questioned by us in Johnson v. Aetna Casualty & Surety Co., 5 Cir. 104 F.2d 22) which produced a result so contrary to the purpose of the contract that the standard policy was modified by introducing the cross-employee exception in the Omnibus Clause, * * *" (Emphasis supplied)

And in Associated Indemnity Corporation v. Wachsmith, et al, 99 P.2d 420. (1940) the Washington Supreme Court said:

"Appellants cite and rely on the case of Kaifer v. Georgia Casualty Co., 9 Cir., 67 F.2d 309. Con-

ceding that the cited case supports the interpretation contended for by appellants herein, we cannot agree with the conclusion reached by the court, nor are we able to follow its reasoning in reaching its conclusion, and we must therefore respectfully decline to follow it."

On page 29 of their brief, Appellees comment on the Montana State District Court decision under the heading of "Montana State District Court Decision". It is at this point in the Appellees' Brief that they have been most unfair and have not correctly represented the issues involved in this Eighth Judicial District case. The Appellees refer to only part of the holding of the District Court case. The Appellees contend or at least infer that the only issue involved was whether or not the loading of the garbage containers with heavy material was within the definition of "loading and unloading" of the involved policy. This is only part of the truth and is grossly misleading to this Court. The Appellant has heretofore filed with this Court, as an exhibit to its Motion for Extension of Time and "Abstention", a complete copy of the Findings of Fact and Conclusions of Law in the State District Court of Traveler's Insurance Company v. American Casualty, et al. Under said paragraph IV, the Honorable Paul G. Hatfield, Judge of the Eighth Judicial District of the State of Montana, made two Findings of Fact which he numbered 1 and 2. We now quote subparagraph number 2 and call the Court's attention to the fact that it is only subparagraph number 1 to which the Appellees referred to on page 30 of their brief and they pointedly failed to make any reference whatsoever to subparagraph 2. The following is that quotation:

"2. That said defendant (The Montana Hardware Company) knew, or in exercise of ordinary care should have known, that the said garbage contained was extremely heavy, and knew or should have known that if the weight of the said garbage contained was suddenly deposited or allowed to be assumed by one man, that it would cause bodily injury and harm to any man so handling the same; that despite said knowledge, the defendant carelessly and negligently failed to warn the plaintiff, Bert W. Court, of the nature of the contents of said garbage contained and failed to warn him of the extremely heavy weight contained in the said container.

66* * *

"Any failure to warn said Bert W. Court of the excessive weight of the allegedly offending garbage container would, in the Court's opinion, be an integral part of loading the city garbage truck with the implied permission of the City of Great Falls and if that failure to warn is found by the trier of fact to be either the sole proximate cause, or a concurring proximate cause, of Court's alleged injury and damage, then both the plaintiff's insurance policy and the policy of American Casualty Company would afford concurrent and overlapping coverage were it not for the specific exclusions in the American Casualty policy hereinafter found applicable."

Thus from the aforesaid quotations of Judge Hatfield's Findings it can be instantly seen that this precise issue was before the Montana District Court at that time, was decided by it, and is currently pending on appeal before the Montana Supreme Court, the ultimate forum wherein the issue should be decided. (Appellant's brief has already been filed therein).

Since every presumption is in favor of the District Court's decision it is very strongly and sincerely believed that Montana will join the large majority of jurisdictions which have interpreted this issue in the manner here contended by the Appellant. The writer strongly suspects that the Appellees are extremely apprehensive that the State District Court's holding will be affirmed as is perhaps best indicated by their continual resistance to any abstention on this hearing as evidenced by their brief in opposition to the aforesaid Appellant's Motion for abstention and as is further evidenced by the first paragraph on the top of page 31 of their brief herein.

Finally in this connection we would again emphasize that the amount involved here is Eighteen Thousand One Hundred Dollars (\$18,100.00); that the controversy is solely between two insurance com-

panies (the injured party has long been paid); that each of the two parties to this appeal have "temporarily" contributed one half of that amount to the settle ment and that consequently the amounts are, relatively speaking, not a great burden on either company. In spite of all this the Appellees continually resist the Appellant's position that the proper forum, namely the Montana Supreme Court, should be allowed to decide the issue very shortly.

Respectfully submitted,
KELLER, MAGNUSON AND REYNOLDS
AND GLEN L. DRAKE
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I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39, of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Foul F / Lynolds
Attorney





NO. 22133 /

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

GEORGE CHARLES MATTHEWS,

Appellant,

v.

UNITED STATES OF AMERICA,

Appellee.

FILED

DEC 28 1967

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APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA

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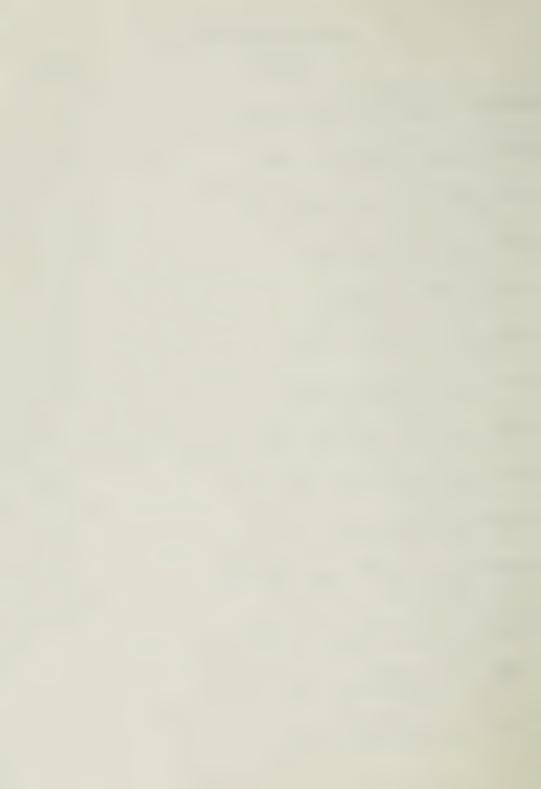


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NO. 22133

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

GEORGE CHARLES MATTHEWS,

Appellant,

V.

1/

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

Ι

JURISDICTIONAL STATEMENT

This is an appeal from the judgment of the United States District Court for the Southern District of California, adjudging appellant to be guilty as charged in all three counts of a Three-Count indictment following trial by jury (C.T. 27). Judgment of acquittal was granted as to Count Three as to appellant after the trial ended. (C.T. 31).

The offenses occurred in the Southern District of California. The District Court had jurisdiction by virtue of Title 18, United States Code, Sections 3231, 2313 and 545. Jurisdiction of this Court rests pursuant to Title 28, United States Code, Sections 1291 and 1294.

[&]quot;C.T." refers to Clerk's Transcript.



STATEMENT OF THE CASE

Appellant was charged, together with Robert Cleburne May, Jr., in each Count of a Three-Count indictment returned on January 18, 1967, by the Federal Grand Jury for the Southern District of California. The First Count alleged that on December 20, 1966 May, and appellant knowingly and intentionally transported a stolen 1961 Chevrolet in foreign commerce from Los Angeles, California, through the Southern District of California, to Tijuana, Baja California, Mexico. (C.T. 2).

The Second Count alleged that on December 21, 1966 May and appellant with knowledge and intent transported the same stolen 1961.

Chevrolet in foreign commerce from Tijuana, Baja California, Mexico to San Diego County in the Southern District of California. (C.T. 3).

The Third Count, on which a judgment of acquittal was granted, alleged that May and appellant knowingly and wilfully smuggled sixty amphetamine tablets into San Diego County from Mexico. (C.1.4).

Jury trial of May and appellant commenced on March 10, 1967 as to all three counts before United States District Judge William P. Copple. May and appellant were found guilty as charged on all three counts on March 13, 1967. (C.T. 9). A written motion for judgment of acquittal, as to Count Three only, (C.T. 30), filed on March 23, 1967, was granted by Judge Copple on March 27, 1967 (C.T. 31).

Thereafter, on April 17, 1967, May and appellant were each committee to the custody of the Attorney General under Title 18, United States Code,



Section 5010(b), Federal Youth Corrections Act for an indeterminate sentence. (C.T. 32, 33).

Appellant filed a Notice of Appeal on April 18, 1967 (C.T. 35). An Order was filed on May 4, 1967 permitting appellant to proceed In Forma Pauperis (C.T. 38).

III

ERROR SPECIFIED

Errors as alleged by appellant are paraphrased as follows:

- There was insufficient evidence of knowledge by appellant to sustain his conviction.
- 2. Prejudicial error was committed by the Trial Court in its failure to instruct the jury that circumstantial evidence may support a conviction only if it is sufficient to enable a reasonable determination that it excludes every reasonable hypothesis except that of guilt.

ΙV

STATEMENT OF THE FACTS

On December 21, 1966 at about 11:00 p.m. (R.T. 73) appellant together with Robert Cleburne May, Jr. entered the United States from Tijuana,

Baja California, Mexico in a 1961 Chevrolet automobile (R.T. 55).

Howard Nolan, an experienced Customs Inspector, referred them to the Secondary Inspection point after the driver, May, informed him they had no key to the trunk. May showed Nolan this particular car could be started without a key. Nolan noted that "There was no key available or in sight."

^{2/ &}quot;R.T." refers to Reporter's Transcript.



Nolan found the pills charged in Count Three under the dash (R.T. 56). Upon questioning, May said "The car is my mother's car." (R. T. 62)

Wayne Tilton, an officer of the San Diego police department advised appellant of his constitutional rights (R.T. 34). He asked Matthews who the car belonged to. Matthews replied "It belongs to his mother", indicating Mr. May. (R.T. 44, 48).

Officer Tilton testified the vehicle was a green 1961 Chevrolet,

Four-Door, bearing California license MDS-518. (R. T. 52)

Ralph Byrd owned the 1961 Chevrolet bearing California license MDS-518 (R.T. 13). He had purchased the car when it was new. Byrd parked his car at 11:00 A.M. on December 21, 1966 (R.T.15) the same date of appellant's return from Mexico in the stolen vehicle. (R.T. 54)

Two hours later, his vehicle was missing. He reported the car stolen immediately. Bryd had never met May nor appellant and didn't give them or anyone else permission to take his car. (R.T. 16). No one ever borrowed his car (R.T. 20). Byrd has a crippled hand and doesn't use a key. (R.T. 18).

Mr. Byrd testified the vehicle was last seen near where Mary

Goldbaum knew May had lived with his sister and also near where

appellant testified he and May were looking for a car to buy. (R.T. 17, 148).

Gary Samuel, Special Agent F. B. I. tried to locate Bill and Mary from February 8, 1967 until the Trial (R.T. 80, 83). Samuel discussed Bill with Mary (R.T. 84).



Mary Goldbaum testified that May lived in the middle of her block,
5 or 6 houses away (R.T. 90, 91). She saw May and appellant at her house
Saturday, the 14th of December. (R.T. 91). She had no party at her house
on December 17th (R.T. 29, 96). No one named "Bill" was there. (R.T. 93).

Goldbaum was visited by appellant and Mrs. Persiata at the Doughnut Shop where she worked (R.T. 94). She knew May by "R.C." Appellant and Persiata wanted Goldbaum to say appellant was at her house. (R.T. 95). She remembered the 17th because she put up her Christmas tree that day. (R.T. 96).

The only people at her house on Wednesday, the 21st, were Mary Ellen and her boy friend (R.T. 96). May's sister lives there and May just moved in and lived there three weeks (R.T. 101).

Mary Ellen Cicarelli testified that she lived in El Monte in the same block Miss Mary Goldbaum lived in. Miss Goldbaum lived at the corner of Rose and Shirley Streets. (R. T. 116-117)

Miss Goldbaum got her Christmas tree on Saturday, December 17, 1966 (R.T. 116-117). She knew Mr. May and he lived near her. She also recalled December 21, 1966 (R.T. 116-118).

She sees Mary every day (R. T. 121) and is at her house every day.

(R.T. 127). She attended all of Mary's parties and never saw a "Bill" at any of Mary's parties (R.T. 123-124).

Dorothy Persiata testified she saw May and appellant Matthews with a man named "Bill" in possession of the 1961 Chevrolet at 5:00 p.m. on December 21, 1966 at her home at 615 North French Street in Santa Ana,



California. No woman was with them. (R.T. 120, 134).

She admitted that she and appellant contacted Mary Goldbaum at work concerning Miss Goldbaum's story. (R.T. 134). She didn't ask Mary where "Bill" could be located (R.T. 141).

Mrs. Persiata denied that May stayed at her house (R.T. 137). She admitted she was a good friend of May and his mother (R.T.) and felt "pretty strongly about this case," and would like to see May acquitted. (R.T. 137, 140). May and May's mother had dinner at her house (R.T. 142).

May and appellant testified they spent the night of December 20, 1966 at Mary's sister's near El Monte. (R.T. 148, 201, 202). They looked at a car near Mary's house (R.T. 149, 168). They claimed they met "Bill" at Mary's house on December 21, 1966 (R.T. 149, 150, 170-171) and went to Mexico with him and four other persons, one of whom was nemd Louise Garcia (R.T. 150, 164, 185). May told Bobby Turnage, F. B. I., a woman was along. (R. T. 205)

None of these five other persons testified (R.T. i and ii), neither told the officers about the other five persons, even after appellant thought the car was stolen. Both gave Mrs. Persiata's residence (R.T. 199-200) as their address (R.T. 162-163, 190). Both admitted lying to the officers in saying the car belonged to May's mothe. (R.T. 153-154, 180).

May claimed they stayed three nights with Mrs. Persiata and appellant claimed they stayed there only two nights. (R.T. 163, 186, 201).

May had been convicted of a felony involving automobile theft. (R.T. 148, 159-161).



May told Bobby Turnage, Special Agent, Federal Bureau of Investigation, a girl named "Bambi" was along (R.T. 205). He didn't mention a Louise Garcia or anyone else besides himself, appellant "Bill" and Bambi. He didn't mention two cars on the trip (R.T. 205). Turnage said the F.B.I. had been unable to locate a "Bill" (R.T. 206, 211). Turnage talked to May at his request on two occasions. He never mentioned "Bill" and Bambi on the first occasion. May told Turnage all four went down in the 1961 Chevrolet (R.T. 209, 210).

V

ARGUMENT

A. THE EVIDENCE OF KNOWLEDGE ON THE PART OF APPELLANT
WAS SUFFICIENT TO SUSTAIN THE CONVICTION.

It is well settled that on appeal, the evidence is viewed most favorable to the government.

Glasser v. United States, 315 U.S. 60, 80 (1942)

Bolen v. United States, 303 F.2d 870 (9th Cir. 1962)

No matter what view of the evidence is taken, the evidence is clear that appellant and May entered the United States from Mexico on December 21, 1966 at 11:00 p.m. as the sole occupant of a 1961 Chevrolet automobile that was stolen from Ralph Byrd between 11:00 a.m. and 1:00 p.m. the same date.

Recent sole or joint, actual or constructive possession of a stolen automobile is sufficient to prove knowledge the automobile was stolen unless the possession is explained to the satisfaction of the Jury.

Wilson v. United States, 162 U.S. 613 (1896)



Morandy v. United States, 170 F.2d 5 (9th Cir. 1948), cert.

denied 336 U.S. 938

McNamara v. Henkel, 226 U. S. 523 (1913)

Corey v. United States, 305 F.2d 232 (9th Cir. 1962)

Jones v. United States, 378 F.2d 340 (9th Cir. 1967)

The Jury, in view of their guilty verdict as to both May and appellant after deliberating only 2-1/2 hours (R.T. 242, 244) no doubt found the entire operation a joint venture.

Apparently they found May and appellant were close friends and associates.

They were to be admittedly looking for an automobile near where the automobile was stolen. They had very little money. (R.T. 149, 168

Both admitted their original claim to officers was false that the vehicle in question belonged to May's mother. This was after appellant admittedly thought the officers suspected the car was stolen. (R.T. 17, 34,44).

Both gave Mrs. Persiata's address as their residence (R.T. 162, 183, 190) and claimed to have stayed there three nights immediately prior to $\frac{3}{4}$ their arrest. Neither claimed to reside there. Mrs. Persiata, a close friend May and his family said they didn't stay at her house, but claimed May and appellant together with "Bill" visited at her house on the way to Tijuana. (R. T. 137). May and appellant claimed to have met "Bill" at a party at May Goldbaum's house on December 21, 1966. (R.T. 149, 150, 170, 171).

 $[\]frac{3}{}$ (R.T. 162-163, 190)



Mary Goldbaum and her friend testified that neither "Bill", May, nor appellant was at her house on December 21, 1966. Both also testified no one named "Bill" was ever at a party at Mary's house. (R.T. 93, 96, 123-124).

Exculpatory statements, later shown to be false, points to a consciousness of guilt.

"Bill" couldn't be found by Federal Bureau of Investigation (R.T. 206, 211).

See: 8.14 Federal Jury Practice and Instructions, Mathes and Devitt and the cases cited therein.

Appellant and Mrs. Persiata visited Miss Goldbaum and tried to get her to back up appellant's story which she refused to do. (R.T. 94, 95).

None of the five other persons May and appellant claimed accompanied them to Tijuana testified.

Appellant made no motion for judgment of acquittal or a motion for a new trial at the close of the Government's case, at the close of the appellant's case nor after instructions were given at the close of the trial. The Court invited such a motion on more than one occasion.

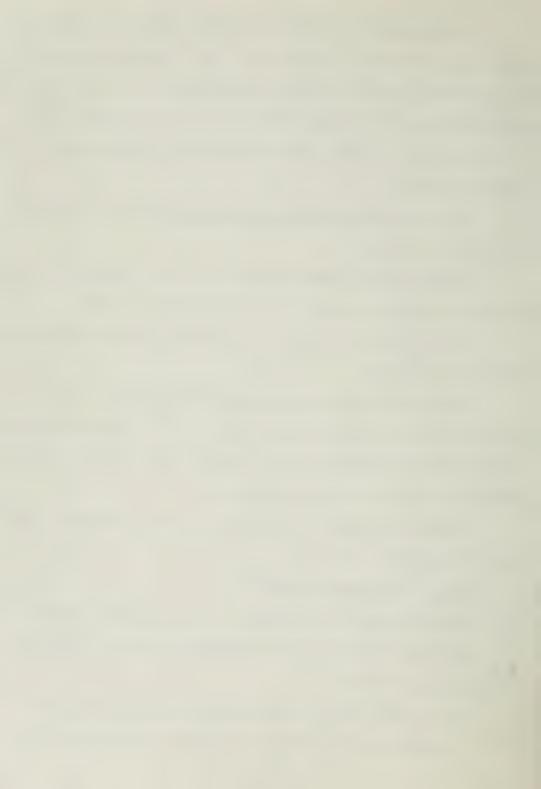
Failure to make such a motion waives any claim to insufficiency of the evidence on appeal.

Corey v. United States, supra at 273

"The evidence was not insufficient merely because the jury might have drawn different inferences or arrived at a different conclusion."

This same case at 238 said,

"The elaborate efforts to conceal the use of assumed names, and the explanations inconsistent with objective circumstances clearly



indicate their falsity were also commonly recognized badges of
fraud from which the jury could infer quilty knowledge."

In the Corey case the conviction of Mrs. Fulgreen was sustained although not in possession of any of the stolen jewelry.

In another Dyer Act case, it was said:

"Inconsistent statements made by appellant and other testimony in the case, however, cast doubt both upon the reasonableness of his explanation and upon his credibility."

Keyes v. United States, 314 F.2d 119, 122 (9th Cir. 1963)

B. THE COURT DID NOT COMMIT REVERSIBLE PREJUDICIAL

ERROR IN FAILING TO INSTRUCT THAT CIRCUMSTANTIAL

EVIDENCE MUST EXCLUDE EVERY REASONABLE HYPOTHESIS

EXCEPT THAT OF GUILT.

Appellant concedes that no objection was made to the instructions as $\underline{4}/$. given by the court. (A.B. 11). This constitutes a waiver of such claim.

Failure to so instruct does not consitute reversible error .

<u>Holland</u> v. <u>United States</u>, 348 U.S. 121, 138-139 (1954)

Bismo v. United States, 299 F.2d 711, 722 (9th Cir. 1962)

Strangway v. United States, 312 F.2d 283 (9th Cir. 1963)

Armstrong v. United States, 327 F.2d 189, 194-195 (9th Cir. 1964)

Ramirez v. United States, 350 F.2d 306, 307 (9th Cir. 1965)

[&]quot;A.B." refers to Appellant's Brief



While some cases appear to hold such an instruction may be desirable there is no error where the court properly instructs on "reasonable doubt" as was done in this case. It is noted the court used and discussed the term "reasonable doubt" on at least 17 occasions.

Except for the element of knowledge the vehicle was stolen, this was not a circumstantial evidence case. Rarely if ever can knowledge or intent be proven other than by circumstantial evidence.

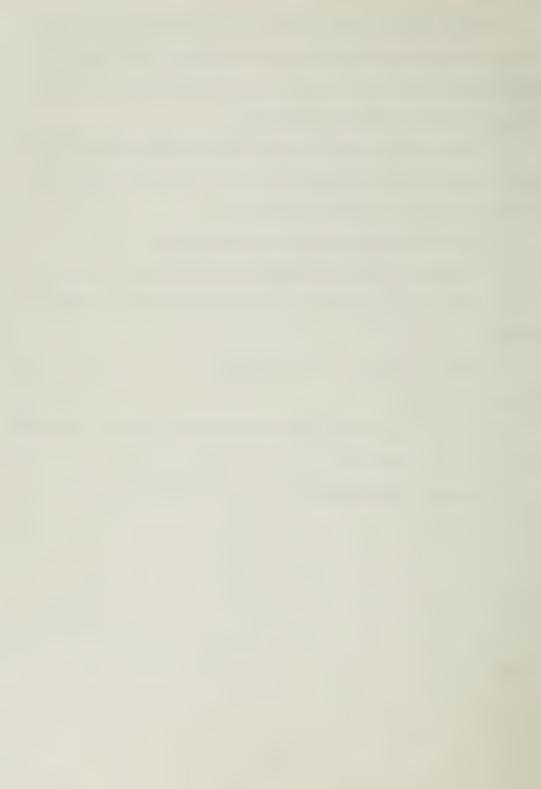
See: 10.06 Federal Jury Practice and Instructions.

Also, see the reasoning in <u>Sanchez</u> v. <u>United States</u>, 341 F.2d 565 (5th Cir. 1965) where, as in this case, a substantial part of the evidence was direct.

"Such an instruction should never be given unless the evidence is not wholly circumstantial."

The court not only held that failure to give such an instruction was not plain error but not error at all.

Leyvas v. United States, 264 F.2d 272 (9th Cir. 1958)



CONCLUSION

For the foregoing reasons, it is respectfully submitted that the jury verdict of guilty in the Court below should be affirmed.

Respectfully submitted,

EDWIN L. MILLER, JR., United States Attorney

SHELBY R. GOTT, Assistant U. S. Attorney

Attorneys for Appellee, United States of America.



CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

SHELBY R. GOTT



IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

GERALD GLEN BOYDEN,

Appellant,

v.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

FILED

OCT 1 1 1967

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NO. 22135

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

GERALD GLEN BOYDEN.

Appellant,

v.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
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NO. 22135

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

GERALD GLEN BOYDEN,

Appellant,

v.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

Ι

STATEMENT OF JURISDICTION

Appellant was indicted by the Federal Grand Jury for the Southern District of California, Central Division for violation of Title 18, United States Code, Section 2113(a)(d) armed robbery of a national bank, on January 20, 1965 [Boyden v. United States, 363 F. 2d 551 (9th Cir. 1966)].

Following a jury trial, appellant was convicted and his conviction was affirmed on appeal [Boyden, Id.].

Appellant filed the subject Section 2255 motion on July 7, 1967 [C. T. 3]. $\frac{1}{}$ On July 7, 1967, an Order Denying Petition was

^{1/} C. T. refers to Clerk's transcript.



filed by the Court [C. T. 5].

Appellant filed, on July 18, 1967, a Notice of Appeal from the above order [C. T. 9].

The District Court had jurisdiction under the provisions of Title 18, United States Code, Sections 2113(a)(d) and 3231, and Title 28, United States Code, Section 2255.

This Court has jurisdiction to review the judgment of the District Court pursuant to Title 28, United States Code, Sections 1291, 1294, and 2295.

II

STATUTES INVOLVED

Appellant's motion, the denial of which is the basis of the instant appeal, was brought under the provisions of Title 28, United States Code, Section 2255, which, in pertinent part, provides:

"A prisoner in custody under sentence of a court established by Act of Congress claiming right to be released upon the ground that the sentence was imposed in violation of the Constitution or laws of the United States . . . , or is otherwise subject to collateral attack, may move the Court which imposed the sentence to vacate, set aside or correct the sentence . . .

"An appeal may be taken to the Court of appeals



from the order entered on the motion as from a final judgment or application for a Writ of Habeas Corpus "

III

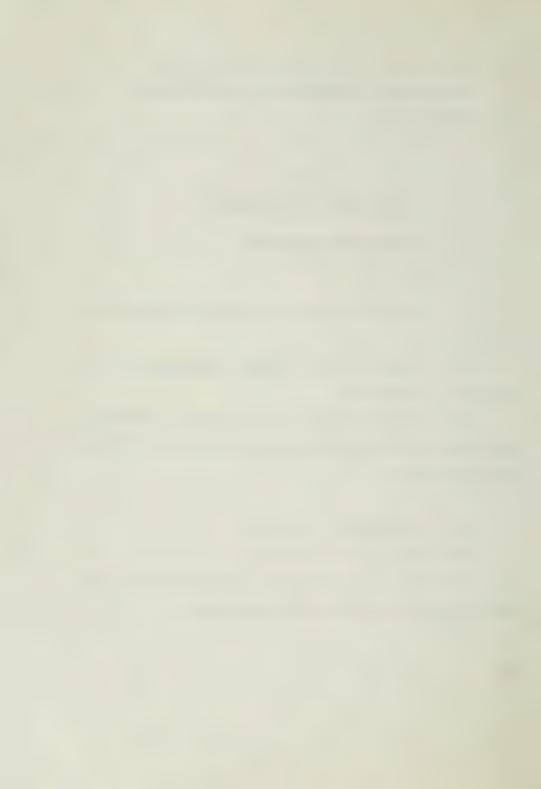
STATEMENT OF THE CASE

A. QUESTIONS PRESENTED.

- 1. Whether a point may be raised for the first time on appeal.
- 2. Whether the rule of Wade v. United States, 388 U.S. 218 (1967), is retroactive.
- 3. Whether appellant could have been compelled to make statements of a non-testimonial nature and wear articles of clothing in a lineup.

B. STATEMENT OF FACTS.

The facts of this case were reviewed by this Court in the direct appeal from the conviction [Boyden, supra].



IV

ARGUMENT

A. APPELLANT CANNOT RAISE A POINT ON APPEAL NOT RAISED BEFORE THE DISTRICT COURT.

Appellant, in his Opening Brief, challenges the holding of a preliminary hearing, alleged used as a lineup, without providing him counsel. Such point was not raised before the District Court, and cannot be raised in this Court, Standley v. United States, 318 F. 2d 700 (9th Cir. 1963), cert. denied, 376 U.S. 917 (1964), reh. denied, 376 U.S. 967 (1964).

B. THE RULE OF WADE v. UNITED STATES, IS NOT RETROACTIVE TO TRIALS HELD BEFORE JUNE 12, 1967.

Appellant's Opening Brief is concerned with skirting the holding of Stovall v. Denno, 388 U.S. 293 (1967), as cited in Judge Curtis' order denying the instant motion. The rule of Stovall is clear, in that the Wade rule affects at p. 296 "only those issues and all future cases which involve confrontations for identification purposes conducted in the absence of counsel after this date" [June 12, 1967].



C. APPELLANT'S RIGHTS WERE NOT VIOLATED BY HAVING HIM WEAR ARTICLES OF CLOTHING OR UTTER STATEMENTS OF A NON-TESTIMONIAL NATURE.

<u>Wade</u>, <u>supra</u>, at pages 222-223 makes it clear that a person in a lineup, even after <u>Wade</u>, may be compelled to put on articles of clothing, and make statements of a non-testimonial nature.

V

CONCLUSION

In short, appellant cannot, at this point, challenge any lineup in which he may have appeared. The judgment of the District Court should be affirmed for the reasons stated in Judge Curtis' order denying relief.

Respectfully submitted,

WM. MATTHEW BYRNE, JR., United States Attorney,

ROBERT L. BROSIO, Assistant U. S. Attorney, Chief, Criminal Division,

RONALD S. MORROW, Assistant U. S. Attorney,

Attorneys for Appellee, United States of America.

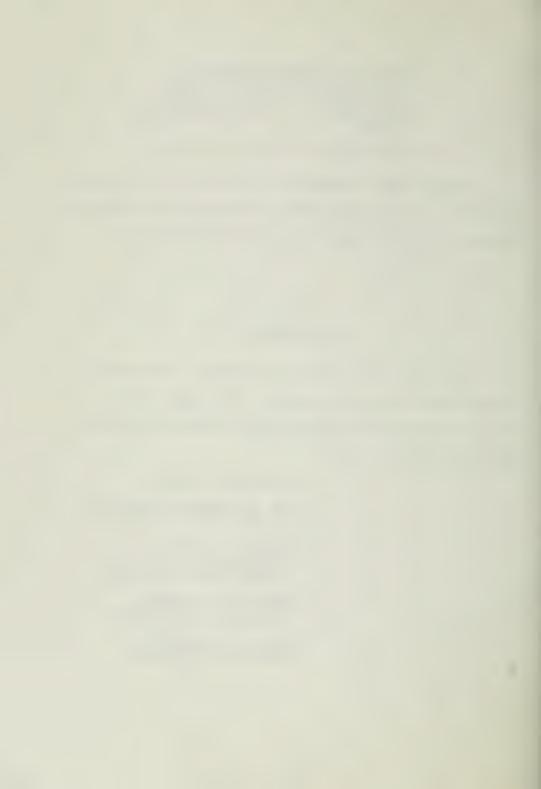


CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Ronald Morrow

RONALD MORROW



CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Ronald Morrow

RONALD MORROW



UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

ALFRED E. MARTINEZ,

Appellant,

vs.

WALTER E. CRAVEN, Warden, of Folsom Prison, and RAYMOND PROCUNIER, California Director of Corrections,

Appellees.

No. 47372

APPELLEES' BRIEF

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FILED

SEP 29 1967

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UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

ALFRED E. MARTINEZ,

Appellant,

VS.

No. 47372

WALTER E. CRAVEN, Warden, of Folsom Prison, and RAYMOND PROCUNIER, California Director of Corrections,

Appellees.

APPELLEES' BRIEF

JURISDICTION

The jurisdiction of this court is conferred by Title 28, United States Code section 2253, which makes an order of a United States District Court in a habeas corpus proceeding reviewable in the court of appeals when, as in this case, a certificate of probable cause has issued.

STATEMENT OF THE CASE AND OF THE FACTS

On July 3, 1967, an order was filed in the United States District Court for the Northern District of California denying a petition by appellant for a writ of habeas corpus. Said order was received by appellees on August 11, 1967, as appellees had not been served with a copy of the petition or any other papers in the matter. That order recites that



petitioner was not seeking to attack the validity of his conviction but rather asserted that he should be released from custody because the warden of Folsom State Prison would not allow him to possess his own personal law books. The Federal District Judge, in dismissing the petition, also referred to the case of <u>Hatfield v. Bailleaux</u>, 290 F.2d 632 (9th Cir. 1961) as containing grounds for dismissing the petition.

In this appeal, appellant still does not attack the conviction under which he is incarcerated. He alleges that that conviction is still pending on appeal (AOB 3). Instead, appellant continues his attack on the prison rules which forbid inmate possession of legal books (AOB 4).

SUMMARY OF APPELLEES' ARGUMENT

I. The decision of the District Court that the allegations of the instant petition do not state grounds for habeas corpus was correct and should be affirmed.

ARGUMENT

Appellant is not attacking the validity of his conviction. He is not attacking the conditions of his confinement. The essence of his complaint is that because the prison officials will not allow him to possess certain law books, this Court must free him from prison. The District Court, noting that appellant was not attacking the validity of his conviction, also premised its decision on the fact



that Hatfield v. Bailleaux, 290 F.2d 632 (9th Cir. 1961) holds that a prisoner does not have a constitutional right to possess his own law books, and therefore, no federal issue of any kind was presented. Of course, the District Court Judge was correct in his statement of the law. This Circuit has repeatedly held that prison rules forbidding possession of law books by inmates does not present any constitutional questions. See also State of Oregon ex rel.

Sherwood v. Gladden, 240 F.2d 910, 912 (9th Cir. 1957).

The defects in the instant petition, then, are manifest. Not only is petitioner failing to attack the validity of his own conviction, he may not do so, as it is presently on appeal in the State appellate courts. 1/Further, he is not attacking the conditions of his confinement. And, finally, the sole point he seeks to raise does not state a constitutional issue, much less a ground for habeas corpus.

/

/

^{1.} Obviously, as to this conviction, state remedies have not as yet been exhausted within the meaning of Title 28 United States Code section 2254.



CONCLUSION

For the foregoing reasons, we respectfully submit that the judgment of the District Court should be affirmed.

DATED: September 27, 1967

THOMAS C. LYNCH, Attorney General of the State of California

ROBERT R. GRANUCCI Deputy Attorney General

AMES A. AIELLO

Deputy Attorney General

Attorneys for Appellees

JAA:cmw CR SF 67-1291



CERTIFICATE OF COUNSEL

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit and that in my opinion this brief is in full compliance with these rules.

DATED: San Francisco, California

September 27, 1967

Peputy Attorney General of the State of California



UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

WARDEN WALTER CRAVEN and THE PEOPLE OF THE STATE OF CALIFORNIA,

Appellants,

vs.

ROBERT EDW. WM. COWLING,

Appellee.

No. 22141

BRIEF FOR APPELLANTS

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UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

WARDEN WALTER CRAVEN and THE PEOPLE OF THE STATE OF CALIFORNIA,

Appellants.

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Appellee.

No. 22141

BRIEF FOR APPELLANTS

JURISDICTIONAL STATEMENT

Appellee, a California State prisoner, filed an application for a writ of habeas corpus pursuant to Title 28, U.S.C., § 2241(c)(3), seeking his release from Folsom State Prison at Represa, California,

The writ was granted by the United States District Court for the Eastern District of California. A certificate of probable cause to appeal was issued August 11, 1967. This appeal is by the State of California pursuant to the provisions of Title 28, U.S.C., § 2253.

STATEMENT OF THE CASE

In an information filed by the District Attorney of Los Angeles County, appellee Robert Edw. Wm. Cowling and his co-defendants William Henry Hudson and Rose Valentine Harris were jointly charged, along with one George Reece,



with possessing heroin for sale on July 26, 1963, in violation of section 11500.5 of the California Health and Safety Code (CT 1). The information also charged appellee Cowling with prior conviction of two felonies, attempted burglary, in Michigan in 1956 and 1959 (CT 2).

Appellee and his co-defendants were arraigned (CT 3-3A), and pleaded not guilty (CT 4, 5, 5A). All waived trial by jury (CT 10), after trial by the court, appellee and his co-defendants Hudson and Harris were found guilty, their co-defendant Reece being found not guilty (CT 12).

As to co-defendant Harris, motion for new trial was denied, criminal proceedings were adjourned, and civil proceedings under section 6451 of the California Penal Code instituted with a stay of execution pending appeal granted (CT 17).

Appellee Cowling's motion for new trial was denied, probation was denied, and he was sentenced to State Prison for the term prescribed by law, no findings having been made as to his alleged prior convictions (CT 18).

In the case of co-defendant Hudson, motion for new trial was denied, proceedings were suspended, and he was granted probation for five years (CT 18A). Appellee and his two co-defendants filed notices of appeal from the respective orders (CT 20-21A).

^{* &}quot;CT" refers to Clerk's Transcript in People v. Cowling, 2 Crim. 9769.



The District Court of Appeal of the State of California, for the Second Appellate District, affirmed the conviction on July 20, 1965, in an unpublished opinion

People v. Cowling, Crim. No. 9769. (A true and correct copy of said judgment is attached to the Return to Order to Show Cause, marked Exhibit B.)

On August 25, 1965; a petition for rehearing was denied, and on September 29, 1965, a petition for hearing in the California Supreme Court was denied. Certiorari was sought from the United States Supreme Court in Cowling v. California, 1060 Misc., October Term 1965. That petition was denied on June 20, 1966 (Cowling v. California, 86 S.Ct. 1959).

On January 24, 1967, a petition for writ of habeas corpus was filed by appellee with the United States District Court for the Eastern District of California, No. Civ. S-185 on the files of said Court. An order to show cause was issued. On March 10, 1967, a return to order to show cause and motion to dismiss was filed. On July 20, 1967, the memorandum and order granting the writ was filed. On August 11, 1967, a certificate of probable cause to appeal was issued.

STATEMENT OF FACTS

On July 26, 1963, James Grennan, a Los Angeles police officer assigned to the narcotic division, was conducting an investigation of the premises at 1946 West 25th



Street in Los Angeles (RT 12-13).

Prior to this time, Officer Grennan had had a conversation with one Robert Sexton, who was known to the officer as a dealer and trafficker in heroin in the Los Angeles area. In the conversation, Officer Grennan discovered a phone number in the possession of Mr. Sexton and the officer learned that appellee's co-defendant Rose Harris lived at the address of the phone number (RT 15-18). Officer Grennan had information that Rose Harris was associated with Sexton and also with one Ted Stanley, whom the officer knew had been arrested for possession of narcotics and whom he knew to be an associate of Sexton. At approximately 4 p.m., on July 26, Officer Grennan received from Sergeant Flynn the substance of a telephone conversation which Sergeant Flynn had had with a confidential informant to the effect that the occupants of 1946 West 25th Street had a large quantity of heroin in their possession which they were packaging for sale (RT 18+19).

Atabout 4:15 on July 26, Officer Grennan went with Sergeants Flynn and Hanks to the address on West 25th Street where they received from the purported owner of the premises permission to use one of the vacant units as a vantage point to observe activities in the unit at 1946 West 25th Street (RT 18-23). While in the vacant unit, Officer Grennan

^{* &}quot;RT" refers to Reporter's Transcript in People v. Cowling. 2 Crim, 9769



observed two women enter and leave the suspect's apartment (RT 55). The officers noted the curtain upstairs move when the women went into the apartment (RT 67).

At the request of the officers the owner of the suspect apartment went to its front door on three separate occasions and tried to gain admission. Twice he received no response and the last time he was told to return later (RT 27-29, 68). He was observed from the second story window of the suspect apartment (RT 28).

Another man, co-defendant Reece, approached the suspect apartment and knocked, then stepped back five or six feet from the door (RT 70). Thereupon, an upstairs window at the address was opened and Officer Grennan observed two male Negroes peer out, one of whom, appellee Cowling, was holding a flour sifter (RT 23-24). Flour sifters are used to dilute heroin by mixing it with sugar (RT 24-25).

After the passage of another period of time, appellee Cowling came out the front door of 1946 West 25th Street and walked around the corner of the courts. The officers left their apartment, stopped appellee Cowling, and identified themselves. Officer Grennan observed apparent hypodermic needle marks upon both of Cowling's arms (RT 25-26). After observing Cowling's general appearance and the pupils of his eyes, Officer Grennan came to the conclusion that Cowling was under the influence of a sedative or opiate drug (RT 31, 41). Thereupon, appellee Cowling was placed



under arrest (RT 42). Officer Grennan obtained a key to the residence from a child in the company of appellee who said that appellee's co-defendant Rose Harris was his mother. With this key Officer Grennan opened the door to the residence (RT 42). It was the experience of the officer that it was common practice for those who were in possession of narcotics to attempt to destroy it when threatened with arrest (RT 95). There was a fire escape in the back of theapartment by the window to the room where the narcotics were found (RT 274). Officer Grennan and Sergeant Hanks entered the residence and went upstairs to the room they believed they had had under observation. Officer Grennan opened the door and said, "Police Officers." He and Sergeant Hanks then stepped into the room and observed co-defendants Harris and Hudson. On the bed in the room was a quantity of narcotics paraphernalia including a funnel, strainer, balloon fragments and a razor blade. There was also a quantity of heroin (Peo. Exhs. 1, 2; RT 96-98). Officer Grennan informed co-defendants Harris and Hudson that they were under arrest. A short time later, Sergeant Flynn entered the bedroom with appellee Cowling and co-defendant Reece. Sergeant Grennan asked to whom the stuff in the bedroom belonged and all denied any knowledge of it (RT 99).

Officer Grennan examined appellee and his co-defendants and found hypodermic marks on the arms of co-defendant Harris, but none on the arms of co-defendant Hudson. Appellee



Cowling had numerous marks on his arms (RT 120).

In Officer Grennan's opinion the amount of heroin in People's Exhibit 1 (more than 68 grams) would have a retail value in excess of \$8,000 (RT 128). The amount of heroin found by Officer Grennan, along with the utensils simultaneously found, led him to believe that the heroin was being prepared for sale (RT 137).

Another officer went to the locked bathroom door, knocked, and was told to wait a moment. After waiting a few minutes he forced in the door (RT 181). Co-defendant Reece was in the bathroom. In the toiletwere a hypodermic needle and an eyedropper. In the sink was a fragment of a blue balloon and a spoon with a darkened bottom (RT 183). This equipment is used in the administration of narcotics (RT 185).

SUMMARY OF ARGUMENT

The police had reasonable and probable cause to enter the suspect apartment to arrest those found therein whom the police reasonably believed were then committing a felony, possession of a narcotic, heroin. Further, the police acted reasonably and legally when they entered without first announcing their presence and intentions. The conduct of those in the apartment, while it was under observation, and the unique arrangement of that abode, plus the knowledge of the fact that those in possession of narcotics can and do try to destroy it when an arrest and seizure is



attempted, reasonably led the police to believe that the seizure would be frustrated if they announced their presence. Indeed, the record proves that this fear was well founded, as when the police finally broke into a locked bathroom, a needle and eyedropper were discovered in the toilet and the fragment of a blue balloon and a spoon with a darkened bottom were in the sink. All of this was narcotic paraphernalia. Further, as the appellee, who was arrested outside of the apartment just prior to the entry, appeared to be under the influence of narcotics, the police could reasonably believe that if an immediate unannounced entry was not effected, those still in the residence might use the narcotics suspected to be therein. Not only would this result in the loss of the evidence, it would injure those who consumed it. Certainly it was not only reasonable, but humane, for the police to act without hesitation to protect the suspects from this degradation and destruction.

ARGUMENT

THE POLICE HAD REASONABLE AND PROBABLE CAUSE TO MAKE THE ENTRY, ARREST, SEARCH AND SEIZURE, AND TO DO SO WITHOUT FORMAL REQUEST FOR ENTRY

At the very outset it should be pointed out that upon direct appeal from his conviction in <u>People</u> v. <u>Cowling</u> (unpublished), the appellee raised the question of the illegality of the search and resulting seizure of heroin. The Appellate Court in passing on this question held as follows:



"Initially, we find no merit in appellant's claim that the contraband was illegally seized because the entry and search which resulted in its discovery were not incidental to a lawful arrest.

"Although the officers had probable cause to arrest each of the defendants including defendant Cowling, the entry and search of the residence was justified as incidental to the arrests of defendants Hudson, Harris and codefendant Reece. Defendants' reliance on cases such as People v. Cruz, 61 Cal.2d 861, which hold that where a defendant was arrested on a public street the search of his house some distance away could not be justified as a lawful incident to his arrest, is clearly misplaced. Here, the entry and search need not be justified as incidental to Cowling's arrest which occurred on the street. The information in the hands of the officers at the time they arrested defendant Cowling gave them probable cause to arrest the persons they knew were still inside the apartment.

"Reviewing this information, the officer's investigation of 1946 West 25th Street had uncovered evidence that defendant Harris, who lived at the address, often associated with narcotics offenders.

A surveillance of the residence was begun shortly before the arrests, when the officers received a tip



from an informant, that the occupants of the residence were then in possession of heroin and were in the process of packaging it for sale. This information was corroborated shortly thereafter, when the officers observed Cowling, standing with another person at the upstairs bedroom window. holding a flour sifter, an instrument normally used only in a kitchen, and which the officers knew was often used by those dealing in narcotics to 'cut' heroin. The suspicions of the officers were then further confirmed when they stopped Cowling for questioning after he left the apartment and observed needle marks on his arms and that he appeared to be under the influence of narcotics. On the basis of this information and their knowledge that at least two persons were still inside the house - defendant Reece whom they had seen enter the premises, and another person (defendant Hudson) whom they had observed looking out of the upstairs window along with Cowling when Reece sought admittance - the totality of circumstances presented justified the officers' belief and 'strong suspicion' that these persons were in possession of heroing The officers thus had probable cause to enter and arrest them. (See People v. Williams, supra, 218 Cal.App.2d 86, 91; People v. Hernandez, 206 Cal.App.2d



253) Noncompliance with the requirements of demand and explanation prior to entry (Penal Code § 844), was justified in order to insure that the contraband would not be destroyed or otherwise disposed of.

(People v. Maddox, 46 Cal.2d 301, 306; In re Sterling, 232 Cal.App.2d .)"

It is, of course, well established that the lawfulness of an arrest is initially a question of state law
(see: <u>United States v. DiRe</u>, 332 U.S. 581; <u>Ker v. State of</u>
<u>California</u>, 374 U.S. 23), but it is ultimately a federal
question where the constitutionality of the state rule is put
into issue (see: <u>Ker v. State of California</u>, <u>supra</u>, at 38).

We submit that the police here had reasonable and probable cause to enter and arrest under both federal and state law.

In the recent decision of the United States Supreme U.S., 17 L.Ed.2d 730, 87 S.Ct., Court in Cooper v. California, the court again reiterated that the relevant test is still as set forth in United States v. Rabinowitz, 339 U.S. 56, 66, that is, whether the search was reasonable.

The law is well settled concerning the right to search incident to an arrest. For example, this Court stated in <u>Preston</u> v. <u>United States</u>, 376 U.S. 364, 367, 11 L.Ed.2d 777, 84 S.Ct. 881 (1964) as follows:

"Unquestionably, when a person is lawfully arrested, the police have a right, without a search



warrant, to make a comtemporaneous search of the person of the accused for weapons or for the fruits of or implements used to commit the crime.

[Citations.] This right to search and seize without a search warrant extends to things under the accused's immediate control, [citations], and, to an extent depending on the circumstances of the case, to the place where he is arrested [citations]."

The law is equally settled that an arrest without a warrant must be based upon probable cause. The test has been set forth in Ker v. California, 374 U.S. 23, 34-35, 10 L.Ed.2d 726, 83 S.Ct. 1623 (1963), as follows:

"The lawfulness of the arrest without warrant, in turn, must be based upon probable cause which exists 'where "the facts and circumstances within their [the officers'] knowledge and of which they had reasonably trustworthy information [are] sufficient in themselves to warrant a man of reasonable caution in the belief that" an offense has been or is being committed. Brinegar v United States, 338 U S 160, 175, 176, 93 L ed 1879, 1890, 69 S Ct 1302 (1949), quoting from Carroll v United States, 267 U S 132, 162, 69 L ed 543, 555, 45 S Ct 280, 39 ALR 790 (1925); accord, People v Fischer, 49 Cal 2d 442, 317 P2d 967 (1957); Bompensiero v Superior Court of San Diego County, 44 Cal 2d 178, 281 P2d



Whether probable cause existed in the minds of the arresting officers must be determined in each case depending upon the particular facts and circumstances (Wong Sun v. United States, 371 U.S 471, 479; and United States v. Law. 190 F. Supp. 100). When police officers act upon information received from an informer whose identity is unknown or undisclosed, probable cause for arrest may exist if such information has been sufficiently corroborated by other circumstance (Newcomb v. United States, 327 F.2d 649; and Bass v. United States, 326 F.2d 884). Among the circumstances which may be taken into account are the background of the suspect (State of Missouri ex rel. Ward v. Fidelity & Deposit Co, of Maryland, 179 F.2d 327) and his conduct when confronted by the officers (Brady v. United States, 148 F.2d 394; United States v. One 1951 Cadillac Coupe, 139 F. Supp. 475; and People v. Avila, 222 Cal.App.2d 83, 34 Cal.Rptr. 677).

We respectfully submit to the Court that the facts in this case, as fully set forth in this brief and in the opinion of the Court in People v. Cowling (unpublished) previously cited at length, establishes that the action of the police was at all times reasonable and in no way violated the appellee's constitutional rights.

The crux of the problem and the basis for the granting of the writ by the court below was the propriety of unannounced entry. The court held:



"As I read the cases, <u>Ker v. State of California</u> marks the outer limits of the doctrine of exigent circumstances (See: e.g., <u>Travis v. United States</u>, 362 F. 2d 477), and accordingly is controlling in the case at bar.

"In Ker the opinion for the Court noted:

failure to give notice is uniquely present. In addition to the officers' belief that Ker was in possession of narcotics, which could be quickly and easily destroyed, Ker's furtive conduct in eluding them shortly before the arrest was ground for the belief that he might well have been expecting the police. We therefore hold that in the particular circumstances of this case the officers' method of entry, sanctioned by the law of California, was not unreasonable under the standards of the Fourth Arendment as applied to the States through the Fourteeneth Amendment.'

"Indeed the Supreme Court emphasized the existence in <u>Ker</u> of a well-founded fear on the part of the arresting officers that the defendant knew that arrest was imminent and might destroy the evidence of his crime by appending a footnote to the above quotation (See: 374 U.S. at 40, Note 12)."



"As I read the cases, <u>Ker v. State of California</u> marks the outer limits of the doctrine of exigent circumstances (See: e.g., <u>Travis v. United States</u>, 362 F. 2d 477), and accordingly is controlling in the case at bar.

"In Ker the opinion for the Court noted:

'... Here justification for the officers' failure to give notice is uniquely present. In addition to the officers' belief that Ker was in possession of narcotics, which could be quickly and easily destroyed, Ker's furtive conduct in eluding them shortly before the arrest was ground for the belief that he might well have been expecting the police. We therefore hold that in the particular circumstances of this case the officers' method of entry, sanctioned by the law of California, was not unreasonable under the standards of the Fourth Amendment as applied to the States through the Fourteeneth Amendment.'

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We do not disagree with this law. We do disagree with its application to this case.

But before going further, we believe it advisable to briefly sketch for the Court the pertinent California law to establish that it is not in conflict with federal law.

The most recent statement of that law by the California Supreme Court is found in <u>People</u> v. <u>Gastello</u>, 67 A.C. 596, 598-599, to wit:

"In Maddox, we held that compliance with the substantially identical notice requirements of Penal Code section 844 for making arrests was excused, if the facts known to the officer before his entry were sufficient to support his good faith belief that compliance would have increased his peril or frustrated the arrest. Later cases have included the prevention of destruction of evidence as an additional ground for noncompliance with section 844. (People v. Covan (1960) 178 Cal.App. 2d 416 [2 Cal.Rptr. 811]; People v. Morris (1958) 157 Cal.App.2d 81 [320 P.2d 67]. Ker v. California (1963) 374 U.S. 23 [10 L.Ed.2d 726, 83 S.Ct. 1623] approved the principle of these cases under Fourth Amendment standards of measonableness. The same principle supports similar exceptions to the

I/ "To make an arrest, . . . a peace-officer, may break open the door . . . of the house in which the person to be arrested is . . . after having demanded admittance and explained the purpose for which admittance is desired."



requirements of section 1531.

"The Attorney General contends that unannounced forcible entry to execute a search warrant is always reasonable in narcotics cases, on the ground that narcotics violators normally are on the alert to destroy the easily disposable evidence quickly at the first sign of an officer's presence.

"We do not agree with this contention. Neither this court nor the United States Supreme Court has held that unannounced forcible entries may be authorized by a blanket rule based on the type of crime or evidence involved

"In Maddox, the officers knocked, heard a male voice call 'wait a minute' followed by the sound of retreating footsteps, and only then forced entry.

Similarly, in People v. Carrillo (1966) 64 Cal.2d 387 [50 Cal.Rptr. 185, 412 P.2d 377], entry followed a knock and observation of suspicious movements. In People v. Smith (1966) 63 Cal.2d 779 [48 Cal.Rptr. 382, 409 P.2d 222], and People v. Gilbert (1965) 63 Cal.2d 690 [47 Cal.Rptr. 909, 408 P.2d 365], the officers were in fresh pursuit of gun-wielding defendants. Similarly, in People v. Hammond (1960) 54 Cal. 2d 846 [9 Cal.Rptr. 233, 357 P.2d 289], officers had cause to believe defendant had a gun and was under the influence of heroin at the time of arrest.



"Thus we have excused compliance with the statute in accordance with established common law exceptions to the notice and demand requirements on the basis of the specific facts involved. No such basis exists for nullifying the statute in all narcotics cases, and, by logical extension, in all other cases involving easily disposable evidence. The statute does not contain the seeds of such far-reaching self-destruction.

"Under the Fourth Amendment, a specific showing must always be made to justify any kind of police action tending to disturb the security of the people in their homes. Unannounced forcible entry is in itself a serious disturbance of that security and cannot be justified on a blanket basis. Otherwise the constitutional test of reasonableness would turn only on practical expediency, and the amendment's primary safeguard -- the requirement of particularity -- would be lost. Just as the police must have sufficiently particular reason to enter at all, so must they have some particular reason to enter in the manner chosen. To the extent that People v. Manriquez (1965) 231 Cal. App.2d 725 [42 Cal.Rptr. 157], and People v. Samuels (1964) 229 Cal.App.2d 351 [40 Cal.Rptr. 290] are contrary to our conclusion herein, they are disapproved."



Two further California cases are uniquely applicable to this case. They are <u>Feople v. Rucker</u>, 197 Cal. App. 2d 18, 17 Cal. Rptr. 98, and <u>People v. Aguilar</u>, 232 Cal. App. 2d 173, 42 Cal. Rptr. 666, which sanctioned unannounced entry when the police had reasonable cause to believe, as here, that narcotics were being administered.

The leading federal case in this regard is <u>Ker</u> v. <u>California</u>, 374 U.S. 23, 10 L.Ed.2d 726, 83 S.Ct. 1623. Therein the Court held:

"Assuming that the officers' entry by use of a key obtained from the manager is the legal equivalent of a 'breaking,' see Keiningham v.

United States, 109 App DC 272, 276, 287 F2d 126, 130 (1960), it has been recognized from the early common law that such breaking is permissible in executing an arrest under certain circumstances.

See Wilgus, Arrest Without a Warrant, 22 Mich L
Rev 541, 798, 800-806 (1924)....

"Finally, the basis of the judicial exception to the California statute, as expressed by Justice Traynor in People v. Maddox, supra (46 Cal 2d at 306), effectively answers the petitioner's contention:

"'It must be borne in mind that the primary purpose of the constitutional guarantees is to prevent unreasonable



invasions of the security of the people in their persons, houses, papers, and effects. and when an officer has reasonable cause to enter a dwelling to make an arrest and as an incident to that arrest is authorized to make a reasonable search, his entry and his search are not unreasonable. Suspects have no constitutional right to destroy or dispose of evidence, and no basic constitutional guarantees are violated because an officer succeeds in getting to a place where he is entitled to be more quickly than he would, had he complied with section 844. Moreover, since the demand and explanation requirements of section 844 are a codification of the common law, they may reasonably be interpreted as limited by the common law rules that compliance is not required if the officer's peril would have been increased or the arrest frustrated had he demanded entrance and stated his purpose. (Read v. Case, 4 Conn. 166, 170 [10 Am. Dec. 110]; see Rest. Torts, § 206, com. d.) Without the benefit of hindsight and ordinarily on the spurt of the moment, the officer must decide these questions in the first instance.

"No such exigent circumstances as would



authorize noncompliance with the California statute were argued in Miller, and the Court expressly refrained from discussing the guestion, citing the Maddox Case without disapproval. 357 US, at 309. Here justification for the officers' failure to give notice is uniquely present. In addition to the officers' belief that Ker was in possession of narcotics, which could be quickly and easily destroyed, Ker's furtive conduct in eluding them shortly before the arrest was ground for the belief that he might well have been expecting the police. We therefore hold that in the particular circumstances of this case the officers' method of entry, sanctioned by the law of California, was not unreasonable under the standards of the Fourth Amendment as applied to the States through the Fourteenth Amendment."

We submit that the facts in this case established "such exigent circumstances as would authorize noncompliance."

Here, as in <u>Ker</u>, the police officer was well experienced in narcotic enforcement and, as in <u>Ker</u>, testified that it was common for addicts or suspects to try to destroy narcotics when the believed they were going to be arrested (RT 95).

Here, as in Ker, there was furtive conduct which



was grounds for the police believing that entry would be denied and the narcotics destroyed. During the period of the police surveillance of the residence two women entered and left it (RT 55). At the time they knocked to gain entry the police observed the curtain upstairs move (RT 67). When co-defendant Reece attempted to gain entry he stepped back from the door (RT 70). Again there was observation of him from the second story window of the suspect house before he was allowed to enter (RT 23-24).

Contrast this admission of three people with what transpired when the landlord, at the request of the police, sought entry. When he knocked he was observed as the others were. But, unlike the others, his first two visits were greeted with silence, his third with the request to return later (RT 27-29, 68).

These facts establish a pattern of checks by the occupants and resulting denial of entry on a selected basis. Certainly it would lead the police to believe they would be denied entry.

The physical arrangement of the residence must also be considered. The suspect room was a bedroom on the second floor which had a fire escape at its back window. A bathroom was also located on that floor. Such aphysical arrangement would render an announced delayed entry a farce for in the interim the narcotics could easily be destroyed. Indeed, the facts show that even under the circumstances



there was an attempt to dispose of narcotic equipment and good reason to believe there was an actual disposal of some of the narcotics (RT 181-183).

Strong as others where unannounced entries have been sanctioned. But, there is more. Appellee was arrested almost immediately after departing from the residence. At that time he had hypodermic marks on both arms and appeared to be under the influence of narcotics (RT 26, 31, 41, 81).

Several of the hypodermic marks appeared to be recent (RI 86). This, plus the other information possessed by the police, would reasonably lead them to believe that narcotics were then being administered in the residence. Under Rucker and Aguilar, this would be considered exigent circumstances.

When all of the facts known to the police are considered as a whole, the conclusion is inescapable that not only was their conduct reasonable, it was commendable.

CONCLUSION

It is respectfully requested that the judgment of the United States District Court for the Eastern District be reversed.

> THOMAS C. LYNCH Attorney General

DORIS H. MAIER Assistant Attorney General

RAYMOND M. MOMBOISSE Deputy Attorney General Attorneys for Appellee

RMM: pm 67-073 12/12/67



CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Deputy Attorney General



IN THE

JNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

Appeal No. 22,142

ERMOUNTAIN RESEARCH AND ENGINEERING COM-ANY, INC., IRECO CHEMICALS, and IRON ORE COMPANY F CANADA,

Plaintiffs-Appellants,

v.

HERCULES INCORPORATED and KAISER STEEL CORPORATION,

Defendants-Appellees.

BRIEF OF PLAINTIFFS-APPELLANTS

FILED

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DEC 4 1967

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ember 1, 1967



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UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

INTERMOUNTAIN RESEARCH AND ENGINEERING COMPANY, INC., IRECO
CHEMICALS, AND IRON ORE COMPANY
OF CANADA,

Plaintiffs-Appellants,

HERCULES INCORPORATED AND KAISER STEEL CORPORATION,

Defendants-Appellees.

Appeal No. 22,142

BRIEF OF PLAINTIFFS-APPELLANTS

STATEMENT ON JURISDICTION

This is an action for infringement of several patents owned by appellants, including Ursenbach, et al. patent No. 3,113,059 (R 83-4)* which issued December 3, 1963 to appellant, Intermountain Research and Engineering Company, Inc., a Utah corporation.

The original Complaint, filed July 15, 1966, (R 2-6) charged that appellees, Hercules Corporation (a Delaware corporation) and Kaiser Steel Corporation (a Nevada corporation), had infringed said patent by acts committed in the then Southern District of California.

Jurisdiction of the District Court arising under the patent laws of the United States and based on 28 U. S. C. §§ 1338(a) and 1400(b) has been admitted by appellees in their Answer, paragraph 1 (R 14).

^{*}R followed by numbers designates pages of the record on appeal.

Before trial, appellees moved for a Summary Judgme (R 57-79, 95) under Rule 56, F. R. C. P., asking the Distri Court to dismiss the Complaint with respect to said pate 3,113,059. The District Court, on June 6, 1967, entered Judgment (R 145-6), Findings of Fact and Conclusions Law (R 142-4) adjudging patent 3,113,059 invalid and dimissing the Complaint as to said patent. In order to avo any question under Rule 54(b), F. R. C. P., the Distri Court on July 5, 1967 entered a Certifying Order directive that said Judgment of June 6 be considered a Final Judgment as to this patent (R 161).

On the same day, July 5, 1967, appellants filed the appeal (R 162-3) from this Judgment pursuant to 28 U.S. \S 1291.

STATEMENT OF THE CASE

The Judgment here on appeal is concerned solely with the validity of patent 3,113,059, one of four patents is volved in this action. Patent 3,113,059, like the other three patents in suit, relates to aqueous slurry blasting compositions which may be used in open pit mines to shatter row and ore formations so that the broken ore can be readiloaded into trucks and removed from the mine for further processing.

Before completion of discovery and before any pretriconference, appellees, on March 17, 1967, filed three mitions: (a) for a stay in discovery with respect to the pricipal patent in suit No. Re. 25,695 (b) for Summary Judgment as to patent 3,249,474 and (c) for Summary Judgment as to patent 3,113,059. All three motions were briefed an argued before The Honorable Manuel L. Real on May 116, 1967 and all three motions were decided from the benewithout opinions on May 16, 1967 (Tr.* 105, 142). On the

^{*} The letters Tr. plus a number refer to pages of the transcrip of oral argument on May 15-16, 1967.

appeal, we are concerned only with the third motion relating to patent 3,113,059.

The District Court at the conclusion of oral argument directed counsel for defendants-appellees to submit a proposed Order with respect to patent 3,113,059 (Tr. 143). Thereupon, the Judgment appealed from, together with the Findings and Conclusions proposed by counsel for appellees, were adopted by the District Court and entered on June 6, 1967 (R 142-6).

This Judgment finds patent 3,113,059 invalid "by virtue of 35 U. S. C. § 102(b) and § 103" and dismisses the Complaint with prejudice to the extent it charges infringement of said patent 3,113,059.

The Findings and Conclusions adopted by the District Court are founded entirely on the Court's own interpretation of the patent in suit (R 83-4) and of printed copies of two prior patents, Faber 1,529,778 (R 74-5) and Taylor, et al. 2,481,795 (R 76-9). These were the only papers submitted by appellees in support of their Rule 56 motion.

Appellants, in opposition to said motion, filed an affidavit of Wayne O. Ursenbach (R 120-3), a qualified expert in aqueous slurry explosives and one of the patentees of patent in suit 3,113,059. The Findings of the District Court ignore the statements in this affidavit.

I. The Ursenbach, et al. Patent In Suit 3,113,059

This patent (R 83-4) describes and claims an aqueous slurry blasting agent composed principally of inorganic nitrates, water and particulate aluminum which has been stabilized by addition of 0.1 to 2% of an ammonium or an alkali metal phosphate so that the slurries can be safely stored for periods of several weeks or months. Without such an inhibitor, these slurries, on prolonged storage, were found to give off hydrogen gas from the reaction of water and aluminum.

These slurry blasting agents usually contain 50% of more of ammonium and sodium nitrates along with 10 1 15% of water and 8 to 20% of aluminum (R 83, col. 1, line 62-4 and col. 2, lines 45-53). The inhibitors found effective as stabilizers according to the patent are the tribasic, dibastor monobasic phosphates of ammonium or alkali metal such as sodium or potassium; diammonium hydrogen phophate is preferred (R 83, col. 1, lines 57-60).

The Ursenbach affidavit states (R 121) that experimentation with a variety of chemicals as stabilizers showed that these ammonium and alkali metal phosphates worked bewehen added in very small amounts.

The claims of the patent in suit read as follows (R 83-4)

- "1. An aqueous slurry blasting agent comprising water, particulate aluminum, an inorganic nitrational oxidizing agent and a stabilizing amount of a phophate selected from the group consisting of amount and alkali metal phosphates.
- 2. The composition set forth in claim 1 containing 0.1% to 2% by weight of said phosphate base on the weight of the composition.
- 3. The composition set forth in claim 1 wherei said phosphate is diammonium hydrogen phosphat
- 4. An aqueous slurry blasting agent comprisin water, particulate aluminum, ammonium nitrate an 0.1% to 2% by weight of diammonium hydroge phosphate based on the weight of said slurry.
- 5. An aqueous explosive system comprisin water, particulate aluminum, an inorganic nitrat oxidizing agent, and a stabilizing amount of a phosphate selected from the group consisting of ammonium and alkali metal phosphates."

Appellees' Findings (R 142-3) adopted by the Districtions Court do not mention these claims or their clear provisions

Claims 1 to 4 specify "an aqueous slurry blasting agent"; claim 5 calls for "an aqueous explosive system". Neither of the prior patents relied upon describes such product.

Claims 1 to 5 specify one of the ammonium or alkali metal phosphates as a part of the aqueous slurry blasting agent or explosive. Neither of the prior patents relied upon describes a single one of these phosphates in an aqueous slurry of any kind.

Patent claims 2 to 4 specify the amount of the phosphate as 0.1% to 2% based on the weight of the slurry composition. Neither of the prior patents relied upon describes this amount of any phosphate in any explosive composition.

II. The Prior Patents Relied Upon By Appellees

A. Faber 1,529,778 issued March 17, 1925

This patent (R 74-5) describes manufacture of a "pyrotechnic article called a 'sparkler'. This device is a short piece of iron wire coated over with a silvered material about one-eighth of an inch thick, which on being lighted throws out sparkles, very much like the sparks from a grinding wheel." (R 74, lines 10-16).

The composition is said to be made up initially of a thick syrup of dextrin in water to which is added aluminum powder, finely divided iron and steel filings, barium nitrate and magnesium carbonate (R 74, lines 16-23). The amounts of these ingredients are not given.

Manufacturers are said to have been troubled by "fermenting" in that this sparkler composition, within three hours' time of being mixed, begins to "bubble and boil, foaming up over the top of the tub and generating a great deal of heat" (R 74, lines 24-37).

Faber suggests (R 74, lines 38-70) this is due to reaction of water with aluminum to form hydrogen which, in turn, reacts with the nitrate part of the barium nitrate to produce ammonia. Speed of the reaction between the finely divided aluminum and water is said to be "increased with the increased alkalinity of the solution" (R 74, lines 59-

62). The magnesium carbonate in the mix "was noticeably alkaline" (R 74, lines 71-73).

Faber, therefore, proposes (R 74, line 79 to R 75, line 6) addition of a mild acid or acid salt "buffer" to "prevent the development of an alkaline reaction in the slurry". Sodium acetate is mentioned as such a buffer (R 74, lines 84-5). Faber then says (R 74, line 107 to R 75, line 2):

"Out of the many soluble and insoluble mild! acids and acid salts which we have in chemistry, all of which would serve in a more or less satisfactory manner the above purpose, I have chosen calcium mono phosphate as the best example."

This is used "in an amount sufficient to act in the capacity of a neutralizing agent for any alkali developed over a period time * * *." (R. 74, lines 92-7). Faber says the proportion of his "buffer" should be 3 to 5% of the composition (R 75, lines 7-14).

Appellees, in their motion, relied solely upon this prior Faber patent as an anticipation under 35 U. S. C. § 102.* Appellees also relied primarily upon Faber as the prior art in arguing that the invention claimed by Ursenbach, et al. was obvious under 35 U. S. C. § 103.* It is pertinent, therefore, to compare the claims of the patent in suit with what Faber describes.

- 1. The patent claims all specify an aqueous slurry blasting agent or explosive system. Faber's wet mix exists as such for only a short time before the material is coated on the iron wires and dried to make sparklers. Faber's composition, wet or dry, is not an explosive of any kind.
- 2. Faber teaches his sparkler mix "bubbles and boils" within a few hours after mixing because its alkaline nature and materials promote a reaction between water and aluminum to form hydrogen that in turn decomposes the

^{*} For the convenience of the Court, 35 U. S. C. §§ 102 and 103 are reproduced in an appendix to this brief.

barium nitrate to form ammonia. The patent in suit says nothing about slurry blasting agents being alkaline. The Ursenbach affidavit states (R 121) that such slurry explosives "are not highly alkaline and do not contain any substantial amount of a carbonate." His patent refers to ammonia gas being evolved only when ammonium nitrate is contained in the slurry (R 83, col. 2, lines 3-5 and 11-19). Faber uses barium nitrate.

- 3. Faber teaches the use of acids or acid salts and, specifically, sodium acetate or calcium mono acid phosphate, as a "buffering" agent to neutralize alkalinity in his sparkler mix. The patent in suit says nothing about buffering agents or acid materials to neutralize alkalinity. The Ursenbach affidavit (R 121-122) states (a) his phosphates are not added for the purpose of chemically neutralizing alkaline materials in the slurry and (b) he is convinced that the phosphates he uses in slurry explosives "do not perform their inhibiting function by reason of any buffering action."
- 4. The patent claims specify as stabilizers the ammonium and alkali metal phosphates. These include the alkaline (tribasic) as well as acid phosphates and they are all different compounds chemically from calcium mono acid phosphate, the single phosphate compound mentioned by Faber.
- 5. Patent claims 2 to 4 specify the amount of the inhibitor as 0.1% to 2% of the weight of the aqueous slurry composition. Faber teaches the use of 3 to 5% of a buffer in his sparkler mix.

B. Taylor 2,481,795 issued September 13, 1949

This patent describes dry explosive compositions that do not contain any aluminum. The compositions are made up of solid ammonium nitrate, ammonium chloride and ground limestone mixed with some high explosives, such as nitroglycerine (examples 1, 2 and 4), or pentaerythritol tetranitrate (example 3), or nitrocellulose (examples 5, 6)

and 7). This patent teaches (R 77, column 3) the use of a non-deliquescent oxidizable ammonium salt and an insoluble metal carbonate to serve as a flame-quenching ingredient when these compositions are exploded.

This patent (R 77, col. 3, lines 60-68) says it "is also sometimes desirable to include" a small amount of an acid buffer salt, mentioning as examples certain acid phosphates. The only reason stated for adding such acid phosphates is to react with "ammoniacal vapors" and "in order to minimize the alkalinity" (R 77, col. 4, lines 17-23).

The Taylor patent has absolutely no pertinence to the claims of the patent in suit because

- (1) Taylor does not describe any kind of aqueous slurry and
- (2) Taylor does not describe any composition containing aluminum.

Furthermore, the preferred inhibitor specified in claims 2 and 4 of the patent in suit, diammonium hydrogen phosphate, is not mentioned in the Taylor patent.

III. Appellants' Affidavit Opposing The Motion

In opposition to the motion, appellants filed the affidavit of Wayne O. Ursenbach (R 120-3), a chemist and an expert in the field of aqueous slurry explosives.

Ursenbach, in his affidavit (R 121), states that the problems with aqueous slurry explosives are encountered only when they are stored for several days or weeks after being mixed. He also points out that acid substances were ineffective as stabilizers and that out of many chemicals tried as inhibitors, the ammonium or alkali metal phosphates were found to be the best materials for use in this type of a composition.

He goes on to point out (R 121-2) that the particular phosphates he has found successful are not added for the

purpose of chemically neutralizing alkaline materials in the slurry, and that the phosphates claimed in his patent do not act as "buffers".

Ursenbach further points out (R 122) why the teaching of the Faber patent is different in function and purpose from his claimed use of a certain class of phosphates and also (R 122-3) why the Taylor patent has nothing to do with the claims of the patent in suit.

Ursenbach concludes (R 123) that if he and the other patentees had had the Faber and Taylor patents before them when they were trying to solve their problem of storing slurry explosives, these prior patents would not have helped at all in making the discovery they made.

The District Court's Conclusions ignore Ursenbach's sworn statements, and the District Court's Findings resolve fact issues, without a trial, contrary to statements in Ursenbach's affidavit.

IV. The Erroneous Findings Of The District Court

Appellants do not challenge Findings 1, 5, 7 and 9.

A. Findings 2 And 3 Are Inaccurate And Misleading

Finding 2 at the outset is inaccurate in stating the invention of the patent in suit "relates to a method". It is also incomplete and misleads by ignoring the fact that the patent claims as a product an aqueous blasting slurry, and that the stabilizers minimize hydrogen evolution when these explosives are stored for weeks or months.

Finding 3, without any support in the record and directly contrary to the description of the patent in suit and statements in the Ursenbach affidavit, finds as a fact that there is nothing unique or critical about the particular phosphates or the amounts thereof that are claimed.

Finding 4 inaccurately characterizes Faber's teaching, ignoring the facts that (a) Faber does not disclose an ex-

plosive composition, (b) Faber does not teach the use of phosphates generally or the claimed phosphates in particular, and (c) Faber teaches the use of acid buffer salts to prevent hydrogen evolution by neutralizing alkalinity.

Finding 6 inaccurately characterizes Taylor's teaching ignoring the facts that (a) Taylor does not describe either an aqueous slurry or any composition containing aluminum and (b) Taylor suggests acid phosphates only to neutralize alkaline ammoniacal vapors.

The conclusory Findings 8 and 10 of anticipation and obviousness, respectively, are totally erroneous, as we shall show.

SPECIFICATION OF ERRORS

The District Court erred

- 1. In holding patent 3,113,059 invalid and void for anticipation under 35 U.S.C. § 102(b),
- 2. In holding patent 3,113,059 invalid and void for obviousness under 35 U. S. C. § 103,
- 3. In adopting Findings 2, 3, 4, 6, 8 and 10 and Conclusions of Law 3 to 8, inclusive, and 10,
- 4. In resolving disputed issues of material facts against the patent in suit without benefit of a trial or expert testimony,
- 5. In failing to consider the presumption of validity of a patent under 35 U. S. C. § 282,
- 6. In entering Summary Judgment without a trial, dismissing the Complaint as to patent 3,113,059.

SUMMARY OF ARGUMENT

The Claimed Invention Is Not Anticipated

The claims of the patent in suit are not anticipated by the prior Faber patent. Anticipation requires prior art which identically describes all of the elements, or their equivalents, of the claimed invention, with these elements doing substantially the same work in substantially the same way.

The claimed invention is an aqueous slurry blasting composition. Faber does not describe either a blasting or explosive composition. The claimed product contains an ammonium or an alkali metal phosphate as a stabilizer. Faber does not describe a composition containing any of the claimed phosphates.

Faber does not describe the preferred diammonium hydrogen phosphate of claims 3 and 4, or the amounts of stabilizer specified in claims 2 to 4.

There is no anticipation of the claims by Faber.

The Findings Of The District Court Are Inaccurate, Incomplete And Misleading

Both the scope and content of the prior art, as well as the differences between the prior art and the claims at issue, must be ascertained factually before the question of obviousness can be decided.

The District Court Findings 4 and 6 did not accurately or completely ascertain the scope and content of the prior art as revealed by the prior Faber and Taylor patents.

Finding 4 is incomplete, inaccurate and misleading in that it implies Faber taught the use of phosphates in his sparkler mix, whereas the only phosphate compound mentioned by Faber was given as an example of an acid salt, and not as an example of a phosphate. Faber's teaching is the neutralizing of alkalinity by adding a mild acid or acid salt.

Finding 6 is incomplete and misleading because the prior Taylor patent does not relate either to aqueous slurries or to explosives containing aluminum, both of which are part of the claimed invention. Taylor mentions acid phosphates only to neutralize ammoniacal vapors.

The District Court did not ascertain factually the differences between the prior art and the claims at issue. Findings 2 and 3 are inaccurate and incomplete with respect to the subject matter of the patent in suit.

Finding 2 ignores the claims and overlooks the facts that the patented slurries are not alkaline, that the stabilizers claimed include alkaline as well as acid phosphates, and that the claimed stabilizers necessarily inhibit wateraluminum reaction by a different chemical reaction than the use of acids or acid salts to neutralize alkalinity.

Finding 3 is inaccurate and unsupported on the record in concluding that neither the particular phosphates nor the amounts set forth in the patent claims is of importance.

The District Court Findings also ignore statements of material facts in the Ursenbach affidavit. That affidavit points out that the claimed aqueous slurry explosives are not highly alkaline, do not contain any substantial amount of a carbonate, and that the phosphate stabilizers claimed in the patent in suit are not added for the purpose of neutralizing alkaline materials in these slurries.

Ursenbach further states that the acids and acid salts taught generally by Faber would not be effective inhibitors in the claimed slurry explosives and that the different phosphates claimed in the patent in suit do not perform their inhibiting function by any buffering action. Finally, Ursenbach concludes that if he had had the Faber and Taylor patents before him, they would not have helped the patentees make the discovery of the patent in suit.

The Claimed Invention Was Not Obvious

The phosphate inhibitors claimed in the patent in suit function by a different chemical reaction than the acid salts of the prior art to accomplish suppression of hydrogen evolution. The prior art teaches use of acid salts to neutralize alkaline mixes and thereby suppress formation and evolution of gases. The claimed aqueous slurry explosives are not alkaline to start with. The phosphate inhibitors that are claimed function as inhibitors because they are phosphates and not because they are acidic.

Whatever chemical reaction is involved to produce the inhibiting effect by the claimed phosphates in the slurry explosives of the patent in suit, it is certain that such reaction is not the neutralizing of an alkalinity that does not exist in those claimed slurry explosives.

To a chemist, therefore, the prior art did not teach that phosphates as a class would act as satisfactory inhibitors in aqueous slurry blasting agents. Furthermore, Faber's short-range suppression of the "fermenting" of a sparkler mix did not teach a chemist how to stabilize slurry explosives during storage for periods of time up to three months.

Resolution Of Disputed Chemical Fact Issues Without A Trial Was Reversible Error

The District Court found anticipation and obviousness only by improperly resolving material disputed issues of fact against the patent in suit. This was improper without a trial. The only factual findings made by the trial court are insufficient to justify either the conclusion of anticipation or the conclusion of obviousness. In fact, the factual findings made by the trial court are unsupported by the papers of the moving party, ignore sworn statements in the Ursenbach affidavit and are inaccurate and misleading.

The mere fact that so many material, and highly technical, fact issues are disputed is alone a sufficient reason for reversing the Judgment of the District Court. Plaintiff is, at least, entitled to a trial of these issues.

ARGUMENT

The appealed Judgment concludes

- (1) that patent in suit 3,113,059 is invalid for anticipation by Faber (Finding 8, R 143 and Conclusions 3 and 4, R 144), and
- (2) that this patent is also invalid over Faber and Taylor for obviousness (Finding 10, R 143 and Conclusions 5-7, R 144).

Both conclusions are erroneous. We shall dispose first of the question of anticipation.

I. There Is No Anticipation Of Any Of The Claims Of The Patent In Suit

35 U. S. C. § 102(b) deals with anticipation. 35 U. S. C. § 103 refers to situations in which "the invention is not identically disclosed or described as set forth in § 102 of this title". Thus, § 102 is talking only about prior patents or publications which *identically* describe the invention. This principle of patent law goes back to the days of Seymour v. Osborne, 78 U. S. 516, 555 (1870).

Deller's Walker on Patents (Vol. 1, 2d Ed., p. 242) says:

"In order to negative novelty, or to 'anticipate' an invention, it is necessary that all the elements of the invention or their equivalents be found in one single description or structure where they do substantially the same work in substantially the same way."

To the same effect is the decision of this Court in Stauffer v. Slenderella Systems of California, 254 F. 2d 127, 128 (9 Cir. 1957). Even where the difference of the claimed construction over the prior art is very slight, there is still no anticipation, as this Court very recently pointed out in Walker v. General Motors Corporation, 362 F. 2d 56, 58 (9 Cir. 1966). See also Ballantyne Instruments & Electronics, Inc. v. Wagner, 345 F. 2d 671, 674 (6 Cir. 1965).

Application of these principles to the facts of this case immediately reveals the error of the District Court in finding anticipation.

Finding 2 (R 142) characterizes the invention of the '059 patent as "a method". The patent claims (supra, p. 4) are not to a method but to an "aqueous slurry blasting agent" (claims 1 to 4) and to an "aqueous explosive system" (claim 5). They are product claims. Neither of the prior Faber or Taylor patents describes in so many words an aqueous slurry blasting agent or explosive system. Taylor, of course, does not describe either an aqueous slurry or any composition containing aluminum, both of which are essential elements of each of the five claims. Thus, Taylor's description cannot anticipate.

Faber's sparkler mix is not a blasting agent or an explosive compound. Faber's mix is simply coated on the iron wires and dried. The sparkler product is something which even small children hold in their hands while the dry mix burns and throws off a shower of harmless sparks. Ursenbach states flatly in his affidavit that Faber does not show an explosive compound (R 122).

The Faber patent contains no mention whatsoever of either the ammonium or alkali metal phosphates specified in the claims. The only phosphate mentioned by Faber, calcium mono acid phosphate, is a salt of an alkaline earth metal, not an alkali metal. Thus, Faber describes neither an explosive product nor the use of the particular phosphate compounds, both of which are specified in claims 1 to 5 of the patent in suit.

In addition, neither of the prior patents describes the particular amount of stabilizer specified in claims 2 to 4, nor the preferred diammonium hydrogen phosphate specified in claims 3 and 4.

In order to find anticipation of the patent claims by Faber, it was necessary for the District Court to conclude factually:

- (1) that Faber's sparkler mix was the same as or equivalent to, the aqueous slurry blasting agents claimed in the patent,
- (2) that calcium mono acid phosphate mentioned by Faber was the same as, or equivalent to, the ammonium and alkali metal phosphates claimed in the patent, and
- (3) that in the claimed compositions the claimed phosphates were acting as "buffers" in the same manner that Faber refers to the use of his acid salts as buffers to neutralize alkalinity.

Anticipation under 35 U. S. C. § 102(b) does not exist unless the prior art describes exactly the same thing that is claimed. The motion papers do not support a single one of the foregoing conclusions. There is no anticipation here.

II. The Claims Of The Patent In Suit Were Not Obvious From The Prior Art Before The Court

The test for obviousness under 35 U. S. C. § 103 was recently laid down by the Supreme Court in *Graham* v. *John Deere Co.*, 383 U. S. 1 (1966). This test is based on several factual inquiries and is as follows (pp. 17, 18):

"Under § 103, the scope and content of the prior art are to be determined; differences between the prior art and the claims at issue are to be ascertained; and the level of ordinary skill in the pertinent art resolved. Against this background, the obviousness or nonobviousness of the subject matter is determined. * * *

"This is not to say, however, that there will not be difficulties in applying the nonobviousness test. What is obvious is not a question upon which there is likely to be uniformity of thought in every given factual context. The difficulties, however, are comparable to those encountered daily by the courts in such frames of reference as negligence and scienter, and should be amenable to a case-by-case development."

We recognize that this Court in Walker v. General Motors Corporation, 362 F. 2d 56, 59 (9 Cir. 1966) resolved the question of obviousness against a factual background. In Walker, however, there was no factual dispute as to what the prior art showed or as to what the patent in suit claimed. The subject matter was extremely simple. Nevertheless, this Court in Walker did point out (p. 59):

"It [a summary judgment] is inappropriate only when a material fact is subject to genuine dispute—as it was in the two cases relied upon by plaintiff: Hughes Blades, Inc. v. Diamond Tool Associates, 300 F. 2d 853 (9th Cir. 1962), and Cee-Bee Chem. Co. v. Delco Chemicals, Inc., 263 F. 2d 150 (9th Cir. 1958)."

The subject matter of the patent here in suit, as well as the subject matter of the prior patents relied upon by appellees, is not simple. This subject is not only chemical but deals with blasting agents—explosives—products which are not even familiar to most chemists. Furthermore, the factual Findings 2, 3, 4 and 6 adopted by the District Court are incomplete, inaccurate and misleading, both as to the nature of the invention claimed in the patent in suit and as to the teaching, or lack of teaching, of the prior art patents.

A. The District Court Did Not Correctly Determine The Scope And Content Of The Prior Art

The only truly factual findings made by the District Court with respect to the teachings of the prior Faber and Taylor patents are Findings 4 and 6, respectively.

As we have shown (*supra*, pp. 5-7), Faber, the principal reference relied upon, described a problem of "fermenting" that occurred in preparing a non-explosive composition suitable for coating iron wires to make sparklers. Faber attributes the "fermenting" to the alkalinity of his mix

which he says promotes and accelerates a reaction between the aluminum and water. Faber's solution to this problem is the addition of a mild acid or acid salt "buffer" to "prevent the development of an alkaline reaction in the slurry". He mentions calcium mono acid phosphate as the best such acid salt and says it should be used "in an amount sufficient to act in a capacity of a neutralizing agent for any alkali developed over a period of time" The foregoing is plainly the teaching of the Faber patent on its face.

Finding 4 reads as follows:

"4. U. S. No. 1,529,778 [Faber] (hereinafter referred to as the '778 patent) teaches the use of buffer salts, and in particular a phosphate salt, to inhibit the gas-evolving aluminum-water reaction in an aqueous slurry composition containing water, particulate aluminum, and an inorganic nitrate."

This Finding is incomplete in that it says nothing about Faber's main teaching of neutralizing alkalinity and says nothing about Faber's proposal to use acids or acid salts for this purpose. This Finding is misleading and inaccurate in that it implies Faber taught the use of phosphate salts generally, whereas the only phosphate compound, calcium mono acid phosphate, is mentioned because it is acid, not because it is a phosphate. Faber does not suggest even indirectly that other phosphate compounds, such as the claimed neutral or alkaline phosphate compounds, would be effective to prevent the fermenting of sparkler mixes or to inhibit a chemical reaction between water and aluminum in a different chemical environment.

Finding 4 further ignores the fact stated by Faber that his "fermenting" occurs within a few hours after the initial preparation of the sparkler mix, and causes the mix to "bubble and boil".

Finding 6, relating to the Taylor patent, reads as follows:

"6. U. S. No. 2,481,795 [Taylor] (hereinafter referred to as the '795 patent) teaches that ammonium

dihydrogen phosphate, sodium dihydrogen phosphate, and alkali metal phosphates in general were known buffer salts which could be incorporated in explosive compositions containing inorganic nitrate."

This Finding is also incomplete and misleading. It does of recognize that Taylor was describing only dry exploives that do not contain any aluminum. It does not recogize that in such a product a reaction between aluminum nd water could not possibly occur. This Finding further gnores the fact that Taylor's only mention of phosphates was again a reference to certain acid phosphates that might e included to neutralize ammoniacal vapors and thus minimize any alkalinity in the product.

B. The District Court Findings Did Not Ascertain The Differences Between The Prior Art And The Claims At Issue

The only findings of the District Court with respect to be subject matter of the patent in suit are Findings 2 and Finding 2 reads as follows:

"2. The alleged invention of the '059 [3,113,059] patent relates to a method of stabilizing aqueous slurries useful as blasting explosives, said slurries containing water, particulate aluminum and an oxidizing agent, e.g., inorganic nitrate, for the purpose of preventing a gas-evolving reaction between the aluminum and water, and specifically involves the addition to such aqueous slurries of an ammonium or alkali metal phosphate for such purpose."

This Finding ignores the claims of the patent in suit and inaccurately refers to the invention as relating to a method'. This Finding is incomplete in that it does not recognize that the problem with the aqueous slurry lasting agents, as stated on the face of the patent, occurred nly when they were stored for weeks or months. This linding is further incomplete in ignoring the facts

(1) that the patented aqueous slurry blasting agents are not alkaline,

- (2) that the particular stabilizers claimed include alkaline as well as acid phosphate compounds, and
- (3) that the invention claimed is the use of a certain class of phosphates to inhibit water-aluminum reaction by a different chemical mechanism than the use of acid salt "buffers" to neutralize alkalinity.

Finding 3 reads as follows:

"3. The '059 patent does not attribute any criticality or uniqueness either to the particular phosphates disclosed and claimed therein to be suitable for such purpose, or to the amounts thereof to be used for such purpose."

This Finding is inaccurate in that the patent in suit definitely specifies the class of ammonium and alkali metal phosphates as best for the purposes of the patentees and specifically states that diammonium hydrogen phosphate (not mentioned by Faber or Taylor) is preferred.

This Finding is further inaccurate in that the patent in suit specifies only a very small amount of stabilizer, stating that more than 2% gives "no apparent added benefit".

There was no basis whatsoever in the papers before the District Court for the implication or conclusion of fact expressed in this Finding that neither the particular phosphates nor the amounts thereof were of importance.

C. The District Court Findings Ignore The Statements Of An Expert In The Ursenbach Affidavit

Findings 1 to 10 do not mention the Ursenbach affidavit or material facts stated therein.

In paragraph 3 (R 121-2), Ursenbach points out that acid chemicals which were tried did not inhibit the aluminum-water reaction liberating hydrogen gas upon storage of the aqueous slurry explosives. He further points out that such explosives are not highly alkaline, do not con-

tain any substantial amount of a carbonate, and that the phosphates found successful are not added "for the purpose of chemically neutralizing alkaline materials in the slurry."

Ursenbach in paragraph 4 (R 122) says that acidic chemicals taught by the Faber patent "would not be effective as inhibitors in our slurry explosives." Also, he points out further "... I am completely convinced that the phosphates used as inhibitors in slurry explosives in accordance with our patent in suit do not perform their inhibiting function by reason of any buffering action."

Finally, in paragraph 6 (R 123), Ursenbach states that the Faber and Taylor patents would not have helped them make their discovery of the patent in suit and that the use of phosphates for his purposes "would not have been obvious to any ordinary explosives chemist from reading these prior patents."

D. The Patent Claims Involve A Different Chemical Reaction Than The Neutralizing Reaction Taught By The Prior Art

The only thing that the patent in suit and the Faber patent have in common is their mention of a reaction between aluminum and water to form hydrogen gas. From this superficial similarity, the District Court leaped to a conclusion of obviousness without determining the "level of ordinary skill in the pertinent art" as required by Graham.

However, Faber and the patent in suit employ entirely different chemical reactions to accomplish the suppression of hydrogen evolution. Also, they are dealing with entirely different chemical compositions to start with.

Faber's sparkler mix is distinctly alkaline. The aqueous slurries of the patent in suit are not.

Faber adds an acid or acid salt to neutralize the alkalinity which he says is responsible for the "fermenting"—

gas evolution. The patent in suit describes and claims addition of a particular class of phosphates (alkaline, neutral and acid) to a slurry that is not alkaline.

The fact that Faber mentions one specific phosphate—calcium mono acid phosphate—as a particularly good acid salt to neutralize alkalinity is not a teaching that other phosphates, including the non-acid ones, would be beneficial merely because they are phosphates.

The phosphates claimed in the patent in suit do not include Faber's calcium mono acid phosphate.

It may well be that the claimed phosphates inhibit reaction between water and aluminum by forming some kind of a protective phosphate coating on the aluminum particles. They may be effective on some other theory. The patent does not advance a theory of operation, stating simply that ammonium and alkali metal phosphates as a class have been found to be effective.

But one thing is certain on the papers before this Court. The claimed phosphates in the slurry blasting agents do not inhibit hydrogen evolution by neutralizing an alkalinity of the slurries that does not exist. They must act because of some different chemical reaction or mechanism.

To a chemist, therefore, Faber's mention of one acid phosphate as an example of acids and acid salts generally would not suggest that phosphates generally (alkaline, neutral or acid) would be effective. This is especially true where, as here, the claimed aqueous slurry explosives to be stabilized.

- (a) do not bubble and boil within a few hours of mixing,
- (b) need to be stabilized for storage over several weeks, and
- (c) do not contain carbonates which produce alkalinity that Faber neutralizes with an acid salt.

The claimed stabilized aqueous slurry blasting agents were not obvious to one skilled in the explosives art from anything described in Faber's sparkler patent.

The Taylor patent adds nothing because it is not concerned with either an aqueous slurry or a composition containing aluminum.

III. It Was Reversible Error For The District Court To Resolve Material Fact Issues Without A Trial

In a summary judgment proceeding, all doubts on factual matters are resolved against the moving party. The rule was well stated by this Court in Cox v. American Fidelity & Casualty Co., 249 F. 2d 616 (9 Cir. 1957), where the Court said (p. 618):

"The summary judgment procedure under Rule 56 has been widely commented upon by all the circuits, but perhaps the best statement on the applicability of the rule was made by the late Judge Jerome Frank of the Second Circuit, when he elaborated on the 'slightest doubt' rule enunciated by the First Circuit as follows:

'We take this occasion to suggest that trial judges should exercise great care in granting motions for summary judgment. A litigant has a right to a trial where there is the slightest doubt as to the facts, and a denial of that right is reviewable; but refusal to grant a summary judgment is not reviewable. Such a judgment, wisely used, is a praiseworthy time-saving device. But, although prompt dispatch of judicial business is a virtue, it is neither the sole nor the primary purpose for which courts have been established. Denial of a trial on disputed facts is worse than delay. [Citing Arenas v. United States, supra * * * The district courts would do well to note that time has often been lost by reversals of summary judgments improperly entered.' Doehler Metal Furniture Co. v. United States, 149 F. 2d 130, 135."

The law is the same on this point in the Courts of Appeals for the other Circuits. See Jacobson v. Maryland Casualty Co., 336 F. 2d 72, 74-5 (8 Cir. 1964) and Bushman Construction Company v. Conner, 307 F. 2d 888, 892-3 (10 Cir. 1962).

We have shown (*supra*, pp. 17-19) that Findings of Fact 4 and 6 do not accurately, or completely, or correctly characterize the state of the prior art as actually taught by the Faber and Taylor patents. The scope and content of the prior art is a necessary factual determination according to the *Graham* case.

We have further shown (*supra*, pp. 19-20) that Findings of Fact 2 and 3 are inaccurate, incomplete and misleading in characterizing the invention of the patent in suit and its claims.

In addition, the trial court findings are wholly inadequate in failing to make any comparison of the differences between the prior art and the claims at issue, a factual determination also required by *Graham*.

Even though the Findings do not so state, it is plain that the conclusion of obviousness could only have been reached by the District Court by resolving against the patent in suit, without the benefit of a trial or expert testimony, the following facts:

- 1. The phosphates in the claimed slurry explosives were acting as buffering agents to neutralize alkalinity, even though Ursenbach in his affidavit stated they were not.
- 2. Faber's mention of calcium mono acid phosphate as an example of an acid salt buffer to neutralize alkalinity would suggest to a chemist that a different class of phosphates would inhibit reaction between aluminum and water in a slurry that did not contain any alkalinity to be neutralized.
- 3. Faber's mention of acid salts and, specifically, calcium mono acid phosphate, to prevent fermenting of a non-

explosive sparkler mix would teach a chemist that other phosphates would not interfere with the exploding properties of aqueous slurry blasting agents after storage for several weeks or months.

We have already demonstrated that each of the above factual findings on the basis of the motion papers would have to be resolved in the negative.

The resolution of the many highly technical, chemical, fact questions involved in this motion was something that the District Court should not have attempted without a trial. As Judge Learned Hand said in *Reiner* v. *I. Leon Co.*, 285 F. 2d 501, 503-4 (2 Cir. 1960):

"The test laid down [35 U. S. C. § 103] is indeed misty enough. It directs us to surmise what was the range of ingenuity of a person 'having ordinary skill' in an 'art' with which we are totally unfamiliar; and we do not see how such a standard can be applied at all except by recourse to the earlier work in the art, and to the general history of the means available at the time. To judge on our own that this or that new assemblage of old factors was, or was not, 'obvious' is to substitute our ignorance for the acquaintance with the subject of those who were familiar with it."

It is manifest from the foregoing that there is a genuine dispute as to many of the material facts which must be resolved in this case before a Court can draw a conclusion of either anticipation or obviousness. These material facts in dispute, unlike the *Walker* case, are not simple but are chemical, highly technical and unfamiliar to the ordinary person.

We respectfully submit that the mere existence of these disputed material facts is sufficient to entitle the plaintiff to a trial on the fact issues involved. Such issues should not have been resolved by the Court in a summary judgment proceeding, and it was reversible error for the District Court to have done so.

CONCLUSION

The Judgment holding patent in suit 3,113,059 invalid and dismissing the Complaint as to said patent should be reversed with an award of costs to appellants.

Respectfully submitted,

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I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Attorney

APPENDIX

U. S. Code, Title 35, Patents

§ 102. Conditions for patentability; novelty and loss of right to patent

A person shall be entitled to a patent unless-

- (a) the invention was known or used by others in this country, or patented or described in a printed publication in this or a foreign country, before the invention thereof by the applicant for patent, or
- (b) the invention was patented or described in a printed publication in this or a foreign country or in public use or on sale in this country, more than one year prior to the date of the application for patent in the United States, or
 - (c) he has abandoned the invention, or
- (d) the invention was first patented or caused to be patented by the applicant or his legal representatives or assigns in a foreign country prior to the date of the application for patent in this country on an application filed more than twelve months before the filing of the application in the United States, or
- (e) the invention was described in a patent granted on an application for patent by another filed in the United States before the invention thereof by the applicant for patent, or
- (f) he did not himself invent the subject matter sought to be patented, or
- (g) before the applicant's invention thereof the invention was made in this country by another who had not abandoned, suppressed, or concealed it. In determining priority of invention there shall be considered not only the respective dates of conception and reduction to practice of the invention, but also

the reasonable diligence of one who was first to conceive and last to reduce to practice, from a time prior to conception by the other.

§ 103. Conditions for patentability; non-obvious subject matter

A patent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 of this title, if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains. Patentability shall not be negatived by the manner in which the invention was made.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Appeal No. 22,142

NTERMOUNTAIN RESEARCH AND ENGINEER-ING COMPANY, INC., IRECO CHEMICALS, and IRON ORE COMPANY OF CANADA, Plaintiffs-Appellants,

1 100/100/10 211

v.

HERCULES INCORPORATED and KAISER STEEL CORPORATION, Defendants-Appellees.

BRIEF OF DEFENDANTS-APPELLEES

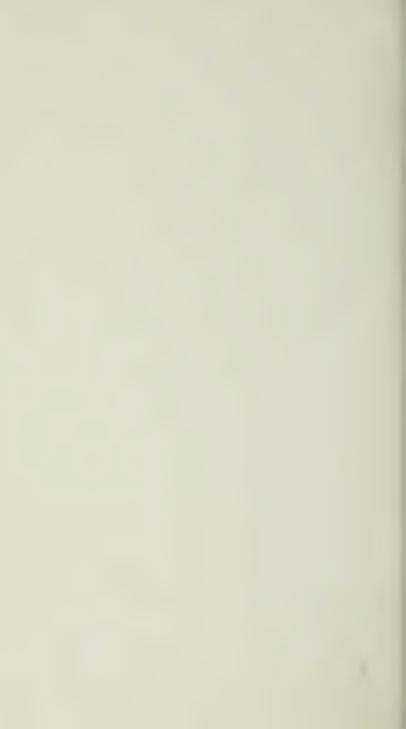
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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

Intermountain Research and Engineering Company, Inc., Ireco Chemicals,
and Iron Ore Company of Canada,
Plaintiffs-Appellants,
v.

Hercules Incorporated and
Kaiser Steel Corporation,

Defendants-Appellees.

Appeal No. 22,142

BRIEF OF DEFENDANTS-APPELLEES

JURISDICTION

This being an action for infringement of a United States Letters Patent, it arises under the patent laws of the United States, 35 U. S. C. §§ 271 and 281. [R 2, 14]* The jurisdiction of the District Court was properly invoked under 28 U. S. C. § 1338(a), and venue is based on 28 U. S. C. § 1400(b). [R 2, 14] U. S. Patent No. 3,113,059 was declared invalid under 35 U. S. C. §§ 102(b) and 103 in a judgment rendered in accordance with Rule 56, F. R. C. P. on June 6, 1967. [R 145-6]**

On July 5, 1967, the District Court entered an Order pursuant to Rule 54(b), F. R. C. P., certifying that the

***35 U. S. C. §§ 102 and 103, and Rules 56(b) and (c) are reproduced in The Appendix hereof.

^{*&}quot;R" followed by a number designates pages of the record on appeal.

aforesaid judgment be considered a Final Judgment. [R 161] Jurisdiction of the Court of Appeals arises under 28 U. S. C. § 1291. The Notice of Appeal was filed in accordance with Rule 73, F. R. C. P. on July 5, 1967. [R 162-3]

STATEMENT OF THE CASE

Appellants' statement is controverted to the extent that certain portions thereof are considered to be inaccurate. Also, it is considered that some amplification is needed in order that the factual setting of this case be fully set forth.

THE PATENT IN SUIT

U. S. Patent No. 3,113,059 (hereinafter referred to as the '059 patent) issued to W. O. Ursenbach and L. L. Udy, and has been assigned to Intermountain Research and Engineering Company, Inc., one of the plaintiffs herein. It relates to a method of chemically treating or stabilizing a slurry containing water, particulate aluminum and an oxidizing agent to prevent or inhibit the reaction of aluminum and water. The reaction of the aluminum and water forms hydrogen, and is stated to be "exothermic" —that is to say, heat is generated by the reaction. ['059 patent, R 83-4, Col. 1, lines 22-26] In addition to the generation of heat and production of hydrogen caused by the aluminum-water reaction in unstabilized slurry mixtures, the '059 patent states that considerable ammonia is evolved if the slurry mixture contains ammonium nitrate (as the oxidizing agent). ['059 patent, Col. 2, lines 3-5]

The specification of the '059 patent discloses that similar problems arise in connection with reclaiming dry, solid explosives which contain particulate aluminum together with oxidizing agents. ['059 patent, Col. 1, lines 31-41]

According to the '059 patent, the addition of a smal amount of a phosphate selected from the group consisting

of ammonium and alkali metal phosphates is effective to nhibit the aluminum-water reaction. Such inhibition is described as stabilization. ['059 patent, Col. 1, lines 50-56]

No theory is advanced in the '059 patent as to how the phosphate addition functions to inhibit the aluminum-water reaction, nor is any criticality or uniqueness there attributed to the narrow class of phosphates disclosed to be suitable for use.

As evidence of the efficacy of phosphate addition, two specific examples are included in the '059 specification. ['059 patent, Examples I and II, Col. 2] In each example, the criterion of success was the amount of gas evolved from an aqueous slurry containing a nitrate oxidizing agent, water and particulate aluminum. In Example I, the oxidizing agent was ammonium nitrate, whereas in Example II a mixture of ammonium and sodium nitrates was used.

Example I involved a comparison of stabilized and untabilized slurries based on the amount of gas evolved during a period of six hours. According to the data set forth in Example I, the unstabilized slurry mixture produced almost three times the amount of gas produced by the slurry mixtures which had phosphate addition. Further, Example indicates that there was a 15°C, temperature rise in the clurry which did not contain phosphate, i.e. the reaction was exothermic.

Example II involved the testing of slurries of different compositions to show the effects of addition of phosphates. The slurries which did not contain phosphates evolved excessive gas after storage for two weeks, whereas the slurries which were formulated with phosphates were stated to have exhibited no evolution of gas.

The '059 patent suggests that from 0.1% to 2% by weight of phosphate, is effective. However, the patent goes on to state that amounts larger than 2% may be used "but

no apparent added benefit appears to result". ['059 patent, Col. 1, lines 61-66]

The patent teaches that the preferred phosphate is diammonium hydrogen phosphate, but indicates that other phosphates such as the tribasic, dibasic, or monobasic phosphates of ammonium or alkali metals such as sodium or potassium may be utilized. ['059 patent, Col. 2, lines 5-60]

No data are provided to justify the allegedly preferred status of diammonium hydrogen phosphate.

No data are provided to show that other phosphates are unsuitable for use in inhibiting the aluminum-water reaction, nor is there even a suggestion that other phosphates are unsuitable.

U. S. Patent No. 3,113,059 does not involve aqueous slurry blasting compositions per se. The alleged invention of the '059 patent is a method of inhibiting the aluminum-water reaction in an aqueous slurry which contains particulate aluminum, water, and an inorganic nitrate. This is clearly set forth in the '059 patent in column 1, lines 42-45 and 50-56, and was also admitted by counsel for plaintiffs-appellants during the oral hearing. [Tr 50-1-2]*

THE PRIOR ART Faber, U. S. 1,529,778

Faber U. S. Patent No. 1,529,778 [R 74-5] issued March 17, 1925. This reference, hereinafter referred to as Faber, is concerned with the inhibition of the aluminum-water reaction in a slurry mixture containing aluminum, water, and an inorganic nitrate. The end use of the slurry mixture of Faber is a pyrotechnic article, i.e., a "sparkler"

^{*&}quot;Tr" followed by a number refers to a page of the transcript of the proceedings in the District Court on May 15-16, 1967.

of the type used by children to celebrate the Fourth of July. The sparkler composition is prepared as an aqueous slurry which is subsequently applied to wires, sticks or the like and dried.

As will be explained in detail below, Faber found that a buffer*, and in particular a phosphate, would inhibit the aluminum-water reaction in his slurry mixture.

In the production of sparklers, according to Faber, there is first formed an aqueous slurry** containing water, particulate aluminum in the form of aluminum powder, and a nitrate oxidizing agent. [Faber, Col. 1, lines 9-21]

Faber states that a recurring problem in the manufacture of sparklers had been the "fermenting" of the aqueous slurry. When such condition occurred, the aqueous slurry began to "bubble and boil, foaming up over the top of the tub and generating a great deal of heat."*** [Faber, Col. 1, lines 24-30]. Faber believed that the "fermenting" was attributable to the reaction of aluminum and water with its accompanying evolution of hydrogen. [Faber, Col. 1, lines 43-54]

In addition, Faber states that the hydrogen so formed reacts with the nitrate to produce ammonia. The ammonia so produced and other by-products of the reaction create an alkaline condition in the slurry. [Faber, Col. 1, line 54 to Col. 2, line 59]

Faber teaches that the addition of a "buffer" would prevent the aluminum-water reaction, and expresses a pre-

^{*}Buffer—"... As the term is most commonly used in chemistry, a buffer is a substance which, upon addition to a system, renders the hydrogen ion concentration resistant to, or less sensitive to, additions of acidic or alkaline substances ..." The Van Nostrand Chemist's Dictionary 105 (1953) [R 61]

Dictionary 105 (1953) [R 61]

**The term "slurry" is used by Faber in Col. 2, at lines 81, 89
and 98, for example. The court below fully appreciated that Faber
was concerned with a slurry. [Tr 53-4]

^{***}i.e., "exothermic". See pp. 2 and 3 hereof.

ference for calcium monoacid phosphate. [Faber, Col. 1 lines 85-87; Col. 2, lines 90-97]

Taylor, et al. U. S. 2,481,795

Taylor, et al. U. S. Patent No. 2,481,795 [R 76-9] issued September 13, 1949. This reference, hereinafter referred to as Taylor, relates in general to ammonium nitrate explosives. The relevance of Taylor to the issues before this Court resides in the disclosure that the explosive art recognized that a variety of phosphates could be used as buffers in ammonium nitrate mixtures.

Judge Real was fully cognizant of the limited purpose for which Taylor was offered by defendants-appellees Thus, at Tr 44:

"[Mr. Churchill] Their second patent [Taylor] has absolutely nothing to do with it. I think Mr Carr in his statement virtually admitted that today That patent doesn't even show a composition containing aluminum particles.

THE COURT: No, he said it was only produced for the purpose of showing there were other buffering agents and those were phosphates."

Taylor shows that sodium dihydrogen phosphate and ammonium dihydrogen phosphate, and alkali metal* phosphates were known buffers which could be incorporated in explosive mixtures containing ammonium nitrate. [Taylor Col. 3, lines 60-69] It is noted that the term "buffer salt' is used by Taylor. [Taylor, Col. 3, line 62] The calcium phosphate disclosed by Faber is a buffer salt, as are the various designated phosphates disclosed in the '059 patent.

^{*}Sodium and potassium are alkali metals. See '059 patent, Col. 1 line 60.

COMMENTS ON APPELLANTS' STATEMENT OF THE CASE

It is not correct that the Findings and Conclusions adopted by the District Court are "founded *entirely* on the Court's own interpretation of the patent in suit (R *83-4) and of printed copies of two prior patents, Faber, 1,529,778 (R 74-5) and Taylor, et al., 2,481,795 (R 76-9)" as contended by appellants at page 3 of their brief.*

As evidenced by the transcript of the proceedings before Judge Real in connection with Defendants' Motion for Summary Judgment on the '059 patent, there was considerable colloquy between the Court and counsel for plaintiffsappellants at the oral hearing on the motion. Several of these exchanges shed considerable light on the factual background of this case. Specific references to the transcript of the proceedings in the District Court are made in various sections of this brief to show that the District Court's decision was not founded entirely upon its own interpretation of the patent in suit and of the two prior art patents upon which the judgment of invalidity was founded.**

The statement at page 3 of appellants' brief that Ursenbach is "a qualified expert in aqueous slurry explosives" has no foundation other than in paragraph 2 of Ursenbach's own affidavit,*** a careful study of which fails to reveal any basis for such a contention. The only portion of paragraph 2 relating to Ursenbach's work with slurry explosives is the last sentence, which merely sets forth that he

^{*}Emphasis added unless otherwise indicated.

^{**}However, in a simple case such as this, the Court could properly have read the '059 patent and the references, and concluded that the patent was invalid in view thereof.

^{***}Plaintiffs filed an affidavit of W. O. Ursenbach in opposition to Defendants' Motion for Summary Judgment. [R 120-3]

has worked for one of the plaintiffs since 1961 on research and development "in connection with" slurry explosives.

Appellants further assert that the Findings of Fact of the District Court "ignore" the statements in the Ursenbach affidavit.* [P. Br. 3]** Appellants' choice of language in this connection is inapt, if not misleading. The lack of reference to the Ursenbach affidavit in the Findings of Fact adopted by the District Court does not justify a conclusion that the Ursenbach affidavit was "ignored" in the adoption by the District Court of such Findings.

On the other hand, and as will be shown hereinafter, the Ursenbach affidavit suffers from a lack of evidentiary facts from which the District Court could reach its own conclusions based thereon. This shortcoming of the Ursenbach affidavit was brought to the Court's attention by counsel for defendants-appellees during oral argument on the Motion for Summary Judgment. [Tr 24-6, 53]

SUMMARY OF ARGUMENT

Identity Of Inventive Concept Negates Validity

The scope of a patent grant should be commensurate with the inventor's contribution to the art. A fundamental factor which must be considered in determining the extent of the contribution is the inventive concept. If the inventive concept of a later invention is found to be identical or very closely related to the inventive concept of an earlier invention, it is said that the earlier invention "anticipates"

^{*}Plaintiffs-appellants did not submit a counter-order, nor did plaintiffs-appellants submit any proposed additional Findings of Fact for the Court's consideration.

^{**&}quot;P. Br." followed by a number refers to a page of plaintiffs-appellants' brief on appeal.

he later invention. Alternatively, the inventive concept of the later invention may be "obvious" in view of the earlier isclosure. Thus, a primary question which must be nswered in determining the validity of a patent is: What is the *inventive concept* underlying the invention?

Here the "inventive concept" of the '059 patent is imple. It is a method of inhibiting the aluminum-water eaction in an aqueous slurry containing a nitrate. The nethod involves the addition of a small amount of phoshate. In '059, the end use of the slurry was a blasting explosive.

The earlier patent of Faber disclosed a virtually idenical inventive concept in that he sought to inhibit the luminum-water reaction in an aqueous slurry containing a itrate. The means he employed was the addition of a mall amount of a phosphate. His slurry was used for making sparklers.

Thus, the "inventive concept" of '059 and Faber were he same. The patentees of '059 contributed *nothing* new to the art. To permit appellants to remove from the public omain that which Faber dedicated in exchange for his patent monopoly is contrary to the basic purpose and tenets of the patent law.

Summary Judgment Was A Proper Remedy

The summary judgment procedure has been developed is the result of a recognition that there are matters undeverving of a full trial. If, on the face of the pleadings and the papers presented to the court, there is no genuine issue of material fact, the court may readily dispose of the matter in a summary fashion without burdening itself and the parties with the time and expense of a trial, the disposition of which would be foreordained. Summary judgment has been recognized as a proper procedure in an appropriate

patent case in which, as in any other case, there appears to be no genuine issue of material fact.

Summary judgment has been found to be an appropriate procedure in many patent cases decided in this circuit, a most recent example of which was *Walker* v. *General Motors Corp.*, 362 F. 2d 56 (9th Cir. 1966), wherein the Courheld the patent in suit to be invalid under 35 U. S. C. § 103 Normally, summary judgment procedures in such cases are confined to those in which both the patent in suit and the prior art, representing earlier inventions, may be easily read and understood by the court.

Thus, if upon reading and understanding the patent in suit and the prior art, the court concludes that the invention of the patent either had been made by another at an earlier date or would have been obvious to anyone ordinarily skilled in the art in the light of what had gone before, the courshould summarily invalidate the patent and dismiss the complaint.

This is just such a case. The '059 patent in suit is simple and easily understood. It relates to a method for inhibiting the aluminum-water reaction in an aqueous slurry which also contains an inorganic nitrate. The reaction is inhibited by the addition of a small amount of a phosphate.

The Faber patent at a much earlier date disclosed that the way to inhibit the aluminum-water reaction in araqueous slurry which also contained a nitrate, was to add thereto a small amount of a phosphate.

A mere reading of the '059 patent and the Faber reference will disclose the above to be the facts. No expert assistance or guidance, nor a full trial is required in their understanding. On the basis thereof, the lower court properly found the '059 patent to be invalid.

As stated in a leading case on summary judgment procedure in this Circuit:

"Judicature is a practical business and the summary judgment procedure has been introduced into our practice as a practical device for the expeditious disposition of litigation where there appears to be no need for the usual type of trial . . .

There are cases in which factual presentation is necessary to make clear the significance of the patent either because of conflicting interpretations of its claims or because the patent, in its nature, is difficult to understand. But there are other cases where there can be little doubt what the patent claims and factual presentation is not necessary to illuminate the alleged invention . . . This appears on its face to be such a case." *Park-In Theatres* v. *Perkins* 190 F. 2d 137, 142 (9th Cir. 1951).

There Is No Presumption of Validity of '059

An issued patent is presumed to be valid. However, this resumption only applies with respect to the prior art atents and publications which were considered by the Exminer in connection with the prosecution of the application or patent. The presumption does not apply with respect to extinent prior art which was never considered in the Patent office. The principal references herein were never condered by the Patent Office.

he Patentees of the '059 Patent Are Charged with Knowledge of The Prior Art

It is well recognized that regardless of whether a patntee has actual knowledge of prior patents, such prior atents are nonetheless properly considered as prior art.

The '059 Patent Is Invalid Under 35 U. S. C. § 102(b)

The '059 patent is directed to an aqueous slurry connining aluminum, water and an inorganic nitrate to which was added a small amount of a phosphate for the purpose of inhibiting the reaction between aluminum and water. It was recognized that such reaction gave off heat and generated hydrogen and ammonia. These effects were found to be deleterious in the slurry which was to be stored for later use as a blasting explosive.

Faber is prior art as to the '059 patent. The inventive concept of Faber, which was earlier in time, was the addition of a small amount of a buffer, such as calcium phosphate, to inhibit the aluminum-water reaction in an aqueous slurry containing aluminum, water and an inorganic nitrate.

Faber recognized that the aluminum-water reaction generated heat in the slurry and gave off hydrogen and ammonia, which adversely affected his slurry.

Thus, the problem confronting the patentees of '059 and Faber was the same and their solution to the problem was the same. In short, the inventive concept of the '059 patent was fully disclosed by Faber 37 years before the application for '059 was filed.

The fact that '059 claims only ammonium and alkali metal phosphates, and particularly diammonium hydrogen phosphate, which is stated to be preferred, does not serve to patentably distinguish it from Faber. There is nothing in the '059 patent to indicate that the claimed phosphates are in any way critical or that other phosphates are unsuitable for the same purpose. Further, there is no denial that the calcium phosphate of Faber would also serve to inhibit the aluminum-water reaction of the '059 patent.

Nor is the limitation as to particular amounts of phosphate in certain of the claims sufficient to patentably distinguish over Faber. Claims 2 and 4 call for 0.1% to 2% of the phosphate, but the patent clearly teaches that more than 2% phosphate can be used, with no apparent added benefit. Faber discloses the use of 3-5% phosphate as an inhibitor.

Clearly, the inventive concept of the '059 patent was disclosed by Faber and as a consequence, the '059 patent is invalid under 35 U. S. C. § 102(b).

The '059 Patent Is Invalid Under 35 U. S. C. § 103

As previously noted Faber disclosed that a buffer, such as calcium phosphate, could be used to inhibit the aluminum-water reaction in an aqueous slurry containing, in addition, an inorganic nitrate

Taylor, admittedly a prior art reference, disclosed that alkali metal phosphates and specifically ammonium dihydrogen phosphate and sodium dihydrogen phosphate were useful as buffers in explosive compositions containing nitrates. The latter two phosphates are the very phosphates disclosed for use in the '059 patent.

It would be obvious to anyone with minimum skill in the art that the aluminum-water reaction in an aqueous slurry containing an inorganic nitrate could be inhibited by employing the Faber method, using the Taylor buffers—ammonium dihydrogen phosphate, sodium dihydrogen phosphate or any alkali metal phosphate. In view thereof, the '059 patent is invalid under 35 U. S. C. § 103.

There Are No Genuine Issues Of Material Fact

In the lower Court, appellants urged upon Judge Real that there were many genuine issues of material fact which precluded the grant of summary judgment herein. These issues were urged in appellants' brief and at oral argument. In view of the utter simplicity of the patent in suit and the two prior art patents presented, the lower Court appreciated that the issues were neither genuine nor material, but were raised merely in an attempt to avoid summary judgment.

For example, appellants urged that Faber inhibited the aluminum-water reaction by a buffering action, whereas no buffering was involved in '059. Appellants overlooked, although the Court did not, the fact that it is totally irrelevant whether or not Faber was correct in his theorization. It is enough that Faber taught the use of a buffer in the form of calcium phosphate to inhibit the reaction, and that the '059 patent merely used other phosphates, which were known buffers, to inhibit the same reaction in the same environment.

Findings Of Fact 2, 3, 4, 6, 8 and 10 Are Supported In The Record

Findings 1, 5, 7 & 9 are not challenged by appellants.

With respect to challenged findings 2, 4 & 6, appellants do not assert that these findings lack support in the record, but generally that they are inaccurate, misleading, or incomplete. Finding 3 is challenged as having no basis in the record.*

Findings 8 and 10, although generally challenged [P. Br. 10], are not otherwise referred to by appellants.

The challenged findings are dealt with in detail hereinafter. The findings are accurate, they are by no means misleading, and they are as complete as is necessary for a disposition of the matter at hand.

Briefly, appellants complain that the lower Court did not, in its Findings, take proper cognizance of the end use of the slurry of the '059 patent, of the particular phosphates employed and the amounts suggested for use, and of the manner in which the phosphates of '059 and the prior art function to inhibit the aluminum-water reaction.

^{*}Whereas the Finding speaks of "criticality or uniqueness", appellants characterize the choice of phosphate and amount thereof merely as being "of importance", without arguing criticality. [See P. Br. 20, 24]

These are immaterial matters which have no bearing on the ultimate issue of validity of the '059 patent. Findings 2, 3, 4 & 6 are confined to material matters on the basis of which the Court concluded, and properly so, that the invention of the '059 patent was described and taught in Faber (Finding 8), and obvious in view of Faber and Taylor (Finding 10), and that hence '059 was invalid.

Having discussed each of the points of the Argument in summary fashion, we will hereinafter discuss each of the same points in more detail.

ARGUMENT

T.

IDENTITY OF INVENTIVE CONCEPT NEGATES VALIDITY

The touchstone of the *quid pro quo* theory of the granting of patents in this country is the correspondence between the patent monopoly and the contribution of the inventor. That is to say, the inventor is entitled to a monopoly which is no more extensive than the metes and bounds of the technological advance which he discloses to the public.

It follows, therefore, that in evaluating a patent to determine whether an inventor is entitled to a limited monopoly, embodied in the patent grant, it is essential that the inventor's contribution to the art be specifically defined and understood. A fundamental factor which must be considered in determining the extent of the contribution made by the inventor is the *inventive concept*. In the event that examination and comparison of an earlier invention with a later invention show that the inventive concepts are identical or very closely related, then there is identity of invention and, in legal parlance, it is said that the earlier invention "anticipates" the later invention. Alternatively, the inventive concept of the later invention may be "obvious" in

view of the earlier disclosure. Thus, a primary question which must be answered in determining the validity of a patent is: What is the *inventive concept* underlying the invention?

In determining the inventive concept, the substance of the invention must be distinguished from its mere form by ascertaining the function of the invention and how it is performed. This Court in *Pierce* v. *Ben-Ko-Matic*, *Inc.*, 310 F. 2d 475 (9th Cir. 1962) succinctly enunciated this principle at 477:

"'... the ingenious application of known principles to a known problem by the use of devices already known and understood to produce a predictable result does not amount to invention. * * * '"

A. The Inventive Concept of '059 is a Simple One

The inventive concept of the '059 patent was the addition of a phosphate to inhibit the undesirable reaction of water and aluminum, in a known aqueous slurry composition which also contained nitrates.

The inventive concept, if any, resides solely in an improvement in an aqueous slurry, which slurry was already known in the prior art to be useful as a blasting explosive. The '059 patent *does not* purport to involve a new blasting slurry *per se*.

That the alleged invention of the '059 patent is narrowly limited to an improvement involving inhibition can be seen by reference to the title thereof, "Inhibited Aluminum-Water Composition and Method". Further, the very first sentence of this patent confirms that the explosive nature of the slurries in question is irrelevant to the issues presented by this appeal:

"This invention relates to the stabilization of aqueous systems containing particulate aluminum."

This is clearly demonstrated by a colloquy between counsel for plaintiffs-appellants and Judge Real during the oral hearing:

"THE COURT: This is not a basic patent on an explosive, is it?

"Mr. Churchill: No, it is on inhibiting an aqueous slurry so that it may be stored and after mixing it is now a blasting agent. Once it is mixed it is a blasting agent. This is something added to that so it may be stored for periods of time such as several days, weeks. It is only after several days or weeks of storage that any problems ever occurred with these things." [Tr 50-1]

The problem of the reaction of aluminum and water in the slurry mixture is in no way involved with the end use of the mixture. In addition, the expedient by which the patentees of the '059 patent allegedly overcome this problem of the aluminum-water reaction in no way affects the end use of the slurry mixture. This was conceded during oral argument by counsel for plaintiffs-appellants:

"THE COURT: Let me ask you, what does this phosphate do in connection with the actual blasting effect of the aqueous slurry that is created by your client?

"Mr. Churchill: I do not think that affects the blasting portions of the product, your Honor, as far as I know, I do not think it makes a better or poorer blasting agent. It simply makes it safer.

"THE COURT: So we come to it, around the circle that it has only to do with the inhibition of aluminum and water deterioration to make a hydrogen gas.

"Mr. Churchill: Making it safe to store; that is right, your Honor." [Tr 52]

B. The Inventive Concept of Faber is Equally Simple

The inventive concept of Faber involved the addition of a buffer, specifically calcium phosphate, to inhibit the undesirable reaction of water and aluminum in an aqueous slurry composition containing a nitrate which produced heat and hydrogen gas. It is clear from Faber that the problem he faced, and his solution thereto, were in no way related to the end use of his slurry which was a pyrotechnic article, a "sparkler".

C. The Issue Presented To This Court Is Simple

It can be seen that the correctness of Judge Real's decision of invalidity may be reviewed without reference to the ultimate use of the slurry mixture. Phrased another way, the issue of the validity of the '059 patent turns on the problems associated with slurries, and not with blasting explosives or sparklers. The importance of making this distinction was recognized in *Graham* v. *John Deere Co.*, 383 U. S. 1 (1966) at 35:

"The problems confronting Scoggin and the insecticide industry were not insecticide problems; they were mechanical closure problems."

In essence, the issue presented to this Court is whether the expedient used by the patentees of the '059 patent is already in the public domain and is therefore available for anyone to use free of restraint. Since Faber taught that a phosphate buffer could be used to inhibit the aluminumwater reaction in an aqueous slurry containing water, an inorganic nitrate and aluminum particles, the public is now free to select *any* phosphate known to be a buffer and use it for the same purpose. To permit appellants to remove from the public domain that which Faber dedicated in exchange for his patent monopoly "flies in the teeth of the purpose" of the patent law. *Aerotec Industries* v. *Pacific Scientific Co.*, 381 F. 2d 795, 802 (9th Cir. 1967).

SUMMARY JUDGMENT WAS A PROPER REMEDY

A. Summary Judgment Is Proper In a Patent Case.

A concise discussion of the merits of the summary judgment procedure, including guidelines for its use, is found in *Park-in-Theatres* v. *Perkins*, 190 F. 2d 137 (9th Cir. 1951) at 142:

"Judicature is a practical business and the summary judgment procedure has been introduced into our practice as a practical device for the expeditious disposition of litigation where there appears to be no need for the usual type of trial. We think the district judge reasonably and correctly concluded that the posture of this case at the time of adjudication showed that there would be no point in taking testimony upon the question of invention. Indeed, neither in the district court nor here has appellant made apparent what, if anything, in addition to the present record might have been useful on the issue of invention. It is true that appellant claims generally that there are material issues of fact in dispute. But as we read the affidavits filed in connection with the motion for summary judgment, they do not disclose the occasion for proof beyond the record already made. Indeed, the affidavits reveal rather clearly that on the issue of invention, the problem here is essentially one of applying legal standards to circumstances adequately before the court.

There are cases in which factual presentation is necessary to make clear the significance of the patent either because of conflicting interpretations of its claims or because the patent, in its nature, is difficult to understand. But there are other cases where there can be little doubt what the patent claims and factual presentation is not necessary to illuminate the alleged invention. Bulldog Electric Products Co. v. Cole Electric Products Co., 2 Cir., 1945, 148 F. 2d 792; Steigleder v. Eberhard Faber Pencil Co., 1 Cir., 1949, 176 F. 2d 604, certiorari denied, 1949, 338 U. S. 893, 70 S. Ct. 244, 94 L. Ed. 548. This appears on its face to be such a case. It was so treated by the parties in the district court and the appellant suggests nothing persuasive to the contrary."

It is submitted that the present case is one which falls squarely within the category referred to in *Park-in-Theatres*, i.e. a case "where there can be little doubt what the patent claims and factual presentation is not necessary to illuminate the alleged invention."

B. Summary Judgment Was Proper In This Case

Appellees attacked the validity of the '059 patent in the Court below as being anticipated under 35 U. S. C. § 102(b) and as being obvious under 35 U. S. C. § 103. Appellants contend that the '059 patent is not invalid under § 102(b) because of a deficiency in the disclosure of the Faber patent. Appellants also contend that the issue of whether the '059 patent is obvious in view of Faber and Taylor under § 103 cannot be determined without a full trial.

Thus, appellants do not challenge the right or power of the lower Court to summarily invalidate the '059 patent under 35 U. S. C. § 102(b) or § 103, but merely contend that this is not an appropriate case for such action.

Appellants cite the case of *Reiner* v. *I. Leon Co.*, 285 F. 2d 501, 503-4 (2d Cir. 1960) to support their position that the issues before the District Court in this case should not have been resolved without a full trial. That case, and its discussion of 35 U. S. C. § 103 has been superseded by *Graham*

John Deere, 383 U. S. 1 (1966).* What is particularly extinent and is therefore repeated here is the following poron of the *Graham* decision which recognizes the difficulties therent in applying the test set forth in 35 U. S. C. § 103:

"This is not to say, however, that there will not be difficulties in applying the nonobviousness test. What is obvious is not a question upon which there is likely to be uniformity of thought in every given factual context. The difficulties, however, are comparable to those encountered daily by the courts in such frames of reference as negligence and scienter, and should be amenable to a case-by-case development." (Graham v. John Deere Co., supra, at 18).

The recent case of Walker v. General Motors Corporaon, 362 F. 2d 56 (9th Cir. 1966), decided by this Court, lied heavily upon the Graham decision for guidance in firming a decision by the lower court on summary judgtent of invalidity under 35 U. S. C. § 103. As stated by the ourt at 59:

"It is true that obviousness must be determined against a factual background [Graham v. John Deere Co., 383 U. S. 1, 86 S. Ct. 684, 15 L. Ed. 2d 545 (1966)], but a summary judgment invariably rests upon a factual foundation. It is inappropriate only when a material fact is subject to genuine dispute—as it was in the two cases relied upon by plaintiff: Hughes Blades, Inc. v. Diamond Tool Associates, 300 F. 2d 853 (9th Cir. 1962), and Cee-Bee Chem. Co. v. Delco Chemicals, Inc., 263 F. 2d 150 (9th Cir. 1958). If the material facts are not disputed, and if on these undisputed facts the difference

^{*}Portions of *Graham* are quoted by appellants at pp. 16-17 of neir brief.

between the alleged invention and the prior art would have been obvious, a summary judgment of invalidity for lack of invention is entirely proper."

According to *Graham*, the basic factual background necessary to a determination of § 103 obviousness relates to three matters:

- 1. The scope and content of the prior art;
- 2. The differences between the prior art and the claims at issue; and
 - 3. The level of ordinary skill in the pertinent art.

In Walker, the Court found that plaintiff did not dispute the fact that the cited reference was prior art as to the patent in suit. In the present matter, there is no dispute that Faber and Taylor are prior art as to the '059 patent.

In Walker, the Court found that the structure disclosed in the prior art reference was simple, requiring no explanation. Here, too, it is abundantly clear that the subject matter of Faber and Taylor are simple, requiring no explanation.

The Court in Walker stated that if the differences between the prior art and the patent in suit would have been obvious to a person of ordinary skill in the art, summary judgment was proper, "without regard to whether other relevant prior art existed in addition to" the reference specifically relied upon. (Id. at 59)

The Court then discussed the requirement of *Graham* relating to "the level of ordinary skill in the pertinent art":

"Thus, the only possible issue of fact was the level of ordinary skill of persons engaged in the art. But this was not a real issue, for it is not subject to serious doubt that if the ordinary skill possessed by persons engaged in the design of automobiles at the time of Walker's 'invention' were postulated at the

minimum conceivable level, Walker's separate tank structure would have suggested itself as a possible solution to a person possessing such skill. . . ."
(p. 59)

In the present case, assuming as in *Walker*, that ordinary skill is postulated "at the minimum conceivable level", it is submitted that the use of phosphates to inhibit the aluminum-water reaction in the '059 slurry "would have suggested itself as a possible solution to a person possessing such skill."

III.

THERE IS NO PRESUMPTION OF VALIDITY OF '059

In general, patents are presumed to be valid. 35 U. S. C. § 282.* However, such presumption of validity cannot extend beyond the scope of the administrative record in the Patent Office, and accordingly, the existence of pertinent prior art not cited by the Patent Office destroys such presumption. Jacuzzi Bros. v. Berkeley Pump Co., 191 F. 2d 632, 634 (9th Cir. 1951); Siegler Corp. v. Coleman Co.,

F. Supp. , 119 U. S. P. Q. 213, 214, (S. D. Cal. 1958) and other cases cited therein.

Neither Faber nor Taylor were cited by the Patent Office or the applicants during the prosecution of the '059 patent.

As set forth in McCulloch Motors Corporation v. Oregon Saw Chain Corp., 234 F. Supp. 256, 260 (S. D. Cal. 1964);

"Even one prior art reference which has not been considered by the Patent Office may overthrow the presumption of the validity."

The existence of Faber and Taylor completely destroys any presumption of validity of '059.

^{*}Reproduced in the Appendix hereof.

IV.

THE PATENTEES OF THE '059 PATENT ARE CHARGED WITH KNOWLEDGE OF THE PRIOR ART

The patentees of the '059 patent are charged with knowledge of all the prior art existent at the time of their alleged invention, irrespective of whether or not the patentees themselves actually knew of the prior disclosures. *Graham* v. *John Deere Co.*, 383 U. S. 1, 36 (1966); *Griffith Rubber Mills* v. *Hoffar*, 313 F. 2d 1, 3 (9th Cir. 1963); *Walker* v. *General Motors Corporation*, 362 F. 2d 56, 60 (9th Cir. 1966).

V.

THE '059 PATENT IS INVALID UNDER 35 U. S. C. § 102(b)

A. The Problem To Which '059 Was Directed

The problem faced by the patentees of '059 was the reaction between aluminum and water in a slurry containing ammonium nitrate. According to the '059 patent, the aluminum-water reaction formed hydrogen and was exothermic and thus created a fire and explosion hazard. ['059 patent, Col. 1, lines 22-30]

B. The '059 Solution To The Problem

The patentees solved the problem by adding to the slurry a phosphate selected from the group consisting of ammonium and alkali metal phosphates. ['059 patent, Col. 1, lines 50-56] The '059 patent further suggests that suitable phosphates include sodium dihydrogen phosphate and ammonium dihydrogen phosphate. ['059 patent, Col. 2, lines 57, 59]

C. Both the Problem and the Solution of '059 Were Previously Disclosed by Faber

In 1925, 37 years before the date of the application for the '059 patent, the Faber patent issued. According to Faber, one of the problems faced in making sparklers was the aluminum-water reaction which occurred in an aqueous slurry containing water, particulate aluminum and a nitrate (oxidizing agent). The aluminum-water reaction was exothermic, and produced hydrogen, and the effects of these phenomena rendered the slurry unfit for use.

The problem faced by the patentees of the '059 patent was in the *slurry* and not in the effectiveness of the blasting composition. It is also abundantly clear that the problem faced by Faber was in the *slurry*, and not in the effectiveness of the sparkler. Accordingly, the fact that Faber converts his slurry into a pyrotechnic article, whereas the '059 patentees use their slurry for blasting purposes, is entirely irrelevant to the question presented to this Court. It matters not what the *end use* of the slurry may be, for the problem—the aluminum-water reaction—*exists and is solved* independent of the end use.

Faber solved the problem by adding a buffer to the slurry composition. Specifically, Faber added a buffer salt, calcium phosphate, which he identified as one of the then most successful buffers. It is clear that Faber appreciated that there were other buffers which would also serve to inhibit the aluminum-water reaction. [Faber, Col. 1, lines 82-84] Appellants seek to divert attention from the clear teaching of the use of a buffer by continually referring to Faber's alternate use of "acids or acid salts". [P. Br. 7].

Thus, once Faber pointed the way to the solution of problems arising from the aluminum-water reaction by incorporation of a buffer, it was a simple matter for the patentees of the '059 patent to select the same or other buffers for this purpose. It is undisputed by appellants that diammonium hydrogen phosphate and alkali metal phosphates are buffers.

D. Claim Limitation To A Particular Phosphate Does Not Create A Patentable Distinction

Claims 1 through 5 recite ammonium or alkali metal phosphates as the phosphate to be used. There is no basis either in the '059 patent or in this record, including the Ursenbach affidavit, which supports a distinction, much less a patentable distinction, between the calcium phosphate of Faber and the ammonium or alkali metal phosphates.

Neither the '059 patent nor the Ursenbach affidavit contains any statement or suggestion that phosphates other than ammonium or alkali phosphates are inoperative for its purpose. The glaring omission from the Ursenbach affidavit of any data to show that phosphates other than those claimed in '059 are inoperative speaks louder than words to establish that there is no criticality associated with the selection of the type of phosphate. See Stallman v. Casey Bearing Company, 244 F. 2d 905, 907 (9th Cir. 1957).

In the '059 patent, there does appear the bald statement, unsupported by any data, that diammonium hydrogen phosphate is the "preferred phosphate". Assuming, arguendo, that such phosphate performs in a more satisfactory manner than Faber's calcium phosphate, this is an insufficient basis on which to predicate the grant of a patent. The Supreme Court in *Smith* v. *Hall*, 301 U. S. 216, 232 (1937), held that the fact that the prior art did not utilize the best possible mode did not destroy its effectiveness as an anticipation.

Simply stated, mere superiority does not confer patentability on an otherwise old invention. See *Celite Corporation* v. *Dicalite Co.*, 96 F. 2d 242, 248 (9th Cir. 1938).

E. Claim Limitation To Percent Phosphate Does Not Create A Patentable Distinction

Claims 2 and 4 of '059 specify that from 0.1% to 2% by weight of phosphate is incorporated in the slurry.*

^{*}The other claims have no such limitation.

Faber discloses that between 3% to 5% may be incorporated in order to obtain the desired inhibition. (Faber, page 2, column 1, lines 10-12).

The range of 0.1% to 2% is entitled to no patentable significance since there has been no showing whatever of criticality relating thereto.

In fact, the '059 patent itself concedes the unimportance of the exact amount of phosphate added. After stating that it "has been found that from 0.1% to 2% by weight of the phosphate inhibitor is effective", the '059 patent goes on to state in the very next sentence that amounts "larger than 2% phosphate" may be used. ['059 patent, Col. 1, lines 61-66] Virtually the same language as appears in the '059 patent relating to the amount of phosphate to be included, was held to be "fatal to a claimed invention" by the Supreme Court in *Dow* v. *Halliburton Co.*, 324 U. S. 320 (1945) at 329:

"The patent recommends that the acid be diluted to a 5% to 20% strength but it is recognized that 'other concentrations may be used, if desired', to achieve the purpose at hand. Such a broad and indefinite specification as to dilution is fatal to a claimed invention."

The mere presence of numerical limitations in claims 2 and 4 cannot serve to remove the subject matter thereof from the prior art. Judge Harrison in *Muehleisen* v. *Pierce*, 114 F. Supp. 503 (S. D. Cal. 1953), *aff'd* 226 F. 2d 200 (1955) quoted with approval at 507 the following holding from a Second Circuit case:

"'A patentee may not arbitrarily select a point in a progressive change and maintain a patent monopoly for all operations in that particular change falling on one particular side of that arbitrarily selected point. It is only where the selected point corresponds with the physical phenomenon and the patentee has discovered the point at which that physical phenomenon occurs that the maintenance of a patent monopoly is admissible.' . . . Kwik Set, Inc. v. Welch Grape Juice Co., 2 Cir., 1936, 86 F. 2d 945, 947 . . ."

F. Faber Satisfied All of the Requirements of § 102 (b)

The aqueous slurry of '059 includes water, an inorganic nitrate, and aluminum particles; a phosphate is used to inhibit the aluminum-water reaction. The aqueous slurry of Faber includes water, an inorganic nitrate, and aluminum particles; a phosphate is used to inhibit the aluminum-water reaction. There is not a scintilla of novelty or original thinking in '059 which would elevate the expedient described therein to the dignity of invention.*

Admittedly, the aqueous slurry of '059 was eventually to be used for blasting purposes, whereas the aqueous slurry of Faber was to be used for making sparklers. However, this Circuit has repeatedly demanded more than mere differences in form in order to find patentable invention. In Bingham Pump Co., Inc. v. Edwards, 118 F. 2d 338 (9th Cir. 1941), the Court said at 340:

"There remains the question as to whether Appel's device does anticipate appellee's device. The differences between the two devices, as stated above and as related by witness McDougall, are in the form or shape of such devices. Are the changes in Appel's device made by appellee sufficient to impart inven-

^{*}Appellants' citation of Stauffer v. Slenderella Systems of California, 254 F. 2d 127 (9th Cir. 1957) is inapt. Here, as contrasted with Stauffer, "... all of the same elements are found in exactly the same situation and united in the same way to perform the identical function. ..." (Ibid, p. 128)

tion to appellee's device? We think not. The rule on that point is an aged one, and is stated in Smith v. Nichols, 21 Wall. 112, 88 U. S. 112, 119, 22 L. Ed. 566, as follows: '* * * But a mere carrying forward or new or more extended application of the original thought, a change only in form, proportions, or degree, the substitution of equivalents, doing substantially the same thing in the same way by substantially the same means with better results, is not such invention as will sustain a patent.'"

Appellants argue that Faber is not in point because his aqueous slurry is not used as an explosive. In *Leishman* v. *General Motors Corp.*, 191 F. 2d 522 (9th Cir. 1951) at 529, the patentee cited as error the fact that a prior art reference used to anticipate and invalidate the patent in suit related "to a different, non-analogous art, with completely different problems". The Court affirmed the holding of the trial court, stating as follows at 530:

"We think that for the reasons we have mentioned in the discussion of the findings on the Schaefer patent, we cannot hold the court's findings with respect to anticipation by the Cunningham patent to be clearly erroneous. We think that the record amply justifies a finding that the new use of the coaxial principle by the appellant in a shaft positioning device is so nearly analogous to the Cunningham patent that the applicability of the device to its new use would occur to a person of ordinary mechanical skill."

It is fully evident that the substitution of other phosphate buffers for the calcium phosphate of Faber to inhibit the aluminum-water reaction in the '059 slurries "would occur to a person of ordinary mechanical skill". In view of the foregoing, it is submitted that the '059 patent is clearly anticipated by Faber and is therefore invalid under 35 U. S. C. § 102(b).

VI.

THE '059 PATENT IS INVALID UNDER 35 U. S. C. § 103

A. The Alleged Invention of '059 Merely Employs A Taylor Phosphate In the Faber Method

In the recent case of Walker v. General Motors Corporation, 362 F. 2d 56 (9th Cir. 1966), it was decided that summary judgment of invalidity for lack of invention under 35 U. S. C. § 103 is entirely proper. It is necessary only that material facts not be in genuine dispute, and that on the basis of such undisputed facts, the differences between the alleged invention and the prior art would have been obvious. Walker v. General Motors Corporation, supra, at 59.

As discussed in detail above, Faber teaches that the aluminum-water reaction in a slurry containing an inorganic nitrate may be inhibited by the addition of calcium phosphate. Faber also discloses that other materials may be used, identifying such operative materials as buffers.

Taylor, issued in 1949, suggests the desirability of utilizing *phosphate* buffer salts in an ammonium nitrate explosive mixture. [Taylor, Col. 3, lines 60-69] Among the buffer salts disclosed as suitable for the suggested use were sodium dihydrogen phosphate and ammonium dihydrogen phosphate. ['059, Col. 2, lines 57, 59] Thus, two specific phosphate salts used by the patentees of the '059 patent were disclosed by Taylor to be effective buffers in ammonium nitrate explosive mixtures some 13 years earlier.

It is clear from the foregoing that:

(a) the use of a buffer salt, and in particular a phosphate salt, to solve the problem faced by the

patentees of the '059 patent was known at least thirty-five years before the application for the '059 patent and was disclosed by Faber, and

(b) specific phosphate salts disclosed by the patentees of the '059 patent as useful in solving the problem were specifically disclosed by Taylor as effective buffers in an ammonium nitrate explosive mixture more than thirteen years before the application for the '059 patent.

Thus, the alleged invention of the '059 patent is nothing more than the use of one of the phosphate salts of Taylor as the buffer salt called for by Faber. Under § 103, the question before Judge Real was whether or not such use of a phosphate was obvious. He concluded that it was obvious, and this Court is now asked to review that determination.

B. It Was Obvious To Use A Taylor Phosphate In the Faber Method

Perhaps the most pertinent law on this question, based upon a fact situation almost identical to that of the present case, is found in *Dow Co.* v. *Halliburton Co.*, 324 U. S. 320 (1945). The problem faced by the patentees, and the solution proposed are set forth by the Court, beginning at the foot of 326:

"Thus prior to the patenting of the Grebe-Sanford process in 1932 the following facts were manifest and elementary to any one skilled in the art: (a) hydrochloric acid would dissolve limestone and inincrease the production of oil wells, as demonstrated by the Frasch patent; (b) hydrochloric acid would also corrode metal with which it came in contact; (c) arsenic compounds and other chemicals could

be added to hydrochloric acid to inhibit this corrosive effect; and (d) inhibited hydrochloric acid could effectively be utilized to remove scale from metal well equipment without corroding the metal. A representative of the Pure Oil Company then suggested to Grebe and Sanford the possibility of acidizing oil wells to increase production. The latter, from their knowledge of brine well acidizing and of corrosion inhibition, immediately recommended the use of hydrochloric acid containing an inhibitor."

The Court then analyzed the foregoing facts to determine whether the contribution of the patentees was invention within the meaning of the patent statutes. Beginning at 327, the Court stated:

"All the Grebe-Sanford process taught was the obvious fact that hydrochloric acid could be inhibited to prevent corrosion while being used to dissolve limestone rock pursuant to the Frasch method of acidizing wells. No new mental or physical operation was required to add, as suggested by the Grebe-Sanford process, an arsenic compound of from 1% to 5% of the weight of a hydrochloric acid solution. No new or unexpected results were obtained by the addition of such an inhibitor. It was perfectly plain to an expert that the metal well equipment would thereby be protected from corrosion. The Grebe-Sanford method, in short, involved in this respect no more than a mere application of an old process of inhibition to a new and analogous use of protecting metal well equipment from corrosion when the well is being acidized to increase production. Such a process lacks the very essence of an invention."

Paraphrasing the legal conclusions reached by the Court in the *Dow* case, it is apparent that in the present case:

All the '059 patent taught was the obvious fact that the aluminum-water reaction in an aqueous nitrate explosive slurry could be inhibited. No new mental or physical operation was required to add, as suggested by the '059 patent, a phosphate buffer salt. No new or unexpected results were obtained by the addition of such an inhibitor. It was perfectly plain to an expert that the aqueous slurry would thereby be stabilized. The '059 patent, in short, involved in this respect no more than a mere application of an old process of inhibition to a new and analogous use of stabilizing an aqueous ammonium nitrate explosive slurry. Such a process lacks the very essence of an invention.

C. Mere Substitution of One Phosphate For Another Is Not Invention

The '059 patent utilizes known salts, shown by Taylor to be useful as buffers in nitrate explosive compositions, to inhibit the same reaction for which Faber utilizes another phosphate buffer salt. In this Circuit it is recognized that the substitution of one known material for another theretofore used for the same purpose is not patentable under 35 U. S. C. § 103. *Griffith Rubber Mills* v. *Hoffar*, 313 F. 2d 1, 3 (9th Cir. 1963).

VII.

THERE ARE NO GENUINE ISSUES OF MATERIAL FACT

In opposing the Motion for Summary Judgment in the Court below, plaintiffs-appellants filed a Statement of Genuine Issues [R 127-8] which comprised seven alleged genuine issues of material fact.

Having failed to convince Judge Real that any of the seven alleged genuine issues of material fact actually existed, appellants apparently have abandoned that course of action and now set forth, at page 15 of their brief, three issues of fact which it contends the Court must have found before deciding that the patent was invalid under 35 U. S. C. § 102(b), and at page 24, three more issues of fact which it is contended, must have been (improperly) resolved against plaintiffs-appellants. All of these matters have been fully discussed in their proper context herein. Summarily stated, these issues are neither genuine nor material.

A. The Mechanism of Inhibition Is Not An Issue

Appellants argue that Faber must fail as an anticipation because he teaches that the aluminum-water reaction is inhibited as a result of a buffer action, whereas the patent in suit is not based on the principle of buffer action. Thus, appellants argue that a genuine issue of material fact exists, i.e. does the phosphate in Faber function in the same manner as the phosphate in '059. This is nothing more than a semantic exercise.

What appellants fail to say is more significant than what they do say. Nowhere in appellants' arguments or in the Ursenbach affidavit is there any contention that the calcium phosphate of Faber would be inoperative to inhibit the aluminum-water reaction in the '059 slurry, or that the phosphates disclosed by Taylor would be inoperative to inhibit the aluminum-water reaction in the '059 slurry.

It is uncontroverted that neither the '059 patent nor the Ursenbach affidavit advances any facts to explain how phosphates serve to inhibit the aluminum-water reaction. On page 13 of appellants' brief, we find the statement that the phosphate inhibitors "function as inhibitors because they are phosphates* and not because they are acidic". No sup-

^{*}There can be no dispute that Faber's calcium phosphate is a phosphate.

port for this statement appears in the patent or in the Ursenbach affidavit; both are totally silent on the mechanism by which the phosphates inhibit the aluminum-water reaction.

Appellants, although attributing a different mechanism to the operation of the '059 patent as contrasted with Faber, have utterly failed to bring forth one shred of evidence which shows that the mechanism is, in fact, different. The statements in the Ursenbach affidavit to which appellants refer in their brief are obviously conclusions, statements of ultimate fact, and hearsay and are therefore objectionable. (See p. 40 infra)

(1) Correctness of Prior Art Theory Is Not An Issue

In any event, the law is well settled that the theory of operation is not a basis for conferring patentability on an otherwise unpatentable invention. The law in this regard is double edged:

- (a) It is immaterial that prior patentee Faber may not have understood the theory upon which his discovery was predicated.
- (b) The mere discovery by later patentees Ursenbach, et al. of a different theory underlying an old invention cannot serve as a stepping stone to a patent.

Floridin Co. v. Attapulgus Clay Co., 125 F. 2d 669 (3d Cir. 1942), involved an appeal from a judgment of invalidity over a prior art reference. The patentee argued that a prior patent failed as a reference because the theory of operation set forth therein was deficient. In rejecting this argument, the Court stated as follows at 671:

"Nor is any possible deficiency in the explanation offered by a prior patent of its governing scientific principle of importance in determining what falls within the purview of its disclosures. Smith v. Hall,

1937, 301 U. S. 216, 57 S. Ct. 711, 81 L. Ed. 1049; Electric Storage Battery Co. v. Shimadzu et al., 3 Cir. 1941, 123 F. 2d 890."

The Supreme Court has also ruled on this point in Smith v. Hall, 301 U. S. 216, 226 (1937):

"Whether Hastings knew fully and precisely the scientific principles involved in the procedure thus outlined is immaterial. It is enough if he knew and used the method with operative success. *DeForest Radio Co.* v. *General Electric Co.*, 283 U. S. 664, 686."

Thus, Faber's belief that his calcium phosphate functioned as a buffer does not detract from the effectiveness of his teaching, even should his theory be incomplete or incorrect. Faber's disclosure is a sufficient teaching of a method of solving the problems arising from the aluminumwater reaction in an aqueous slurry containing an inorganic nitrate and aluminum. If followed by a member of the public, it would have produced the success described in the '059 patent. It would likewise have infringed the '059 patent. Accordingly, since that which infringes if after also anticipates if before, Faber is clearly an anticipation of the alleged invention of the '059 patent. See *Aerotec Industries* v. *Pacific Scientific Co.*, 381 F. 2d 795, 803 (9th Cir. 1967).

In short, if the '059 phosphates succeed in inhibiting the aluminum-water reaction because they are phosphates, then Faber is an anticipation under 35 U. S. C. 102(b). If the phosphates of '059 are successful because of a buffering action, then also Faber is an anticipation of the alleged invention of the '059 patent under 35 U. S. C. § 102(b). There is no genuine issue of material fact standing in the way.

(2) The Reaction Conditions in '059 and Faber Are Identical

Appellants argue that the incorporation of magnesium arbonate in the Faber slurry makes it alkaline, whereas the 059 slurry does not include any carbonates.* Thus Faber ould not have been solving the same problem or doing so in the same way as '059. Appellants further argue that the execution of using a phosphate buffer, as taught by Faber, is therefore not applicable to the problems facing the '059 patentees.

Such an argument not only is not supported by the teaching of Faber, but it runs counter thereto. Faber states that the phosphate buffer is included to act as a neutralizing gent "for any alkali developed over a period of time . . ." Faber, Col. 2, lines 94-5] The alkalinity "developed" in the laber slurry is a direct consequence of the aluminum-water eaction. As stated in Faber beginning at line 52 in column

"Aluminum acting on water produces hydrogen by the decomposition of the water. This hydrogen reducing the nitrate of barium not only produces ammonia, which in itself gives an alkaline reaction, but the by-products of the reaction, other than that of ammonia, are also alkaline."

In addition Faber further states beginning at line 74 in ol. 2:

"It is likely that in almost all of the operations where this composition [slurry] is used at some time or other an alkali is developed either from the materials used or from the water."

^{*}The wording of appellants' brief on this point is in contrast to the Ursenbach affidavit on which it is allegedly based. Referring to the '059 slurry, compare:

[&]quot;. . . a slurry that is not alkaline." [P. Br. 22, line 3]

[&]quot;... slurry explosives are not highly alkaline [R 121, line 28]

As stated in the '059 patent, at column 2, lines 3-5 ammonia is also produced in the slurry, and such ammonia provides an alkaline reaction just as it does in Faber Indeed, where the slurries and the reactions occurring are virtually identical, if one is alkaline, the other must be.

Faber indicates that it was a known fact that the speed of the reaction between finely divided aluminum and water is increased with increasing alkalinity. [Faber, Col. 2, line 59-62] Judge Real fully appreciated the role played by the alkalinity of the slurry, namely that it "speeds up the processes" involved in the aluminum-water reaction. [Tr 40-1]

Thus, it is abundantly clear that the aluminum-water reaction in the '059 slurry is related to alkalinity in the same manner as in Faber.

No genuine issue of material fact is raised thereby.

B. The Duration of the Period of Inhibition is Irrelevant and Immaterial

Appellants repeatedly argue that the '059 problem is different than that in Faber because the time span between the initial mixing of the slurry and the advent of the aluminum-water reaction is different in each case. Appellants point to the disclosure in Faber which indicates that the aluminum-water reaction commences within three hours' time of being mixed. The Ursenbach affidavit, relied upon by appellants, stated that the problems arising from the aluminum-water reaction "were encountered in storing such slurry explosives for several days or weeks after they were mixed".* [R 121]

This entire contention is unsound. Example I of the '059 patent states that the aluminum-water reaction

^{*}In appellants' brief at the foot of page 8, it is asserted that the Ursenbach affidavit states that the problems with aqueous slurry explosives are encountered *only* when stored for several days of weeks. Clearly, this is an incorrect representation of the affidavit See R 121, para. 3.

occurs in the slurry to a considerable extent within the first vix hours at a temperature above ambient, 81°C. Faber indicates, at Column 2, beginning at line 66, that sometimes vix or eight hours elapse before any reaction starts. Accordingly, it is self-evident that the time span between mixing of the slurry and commencement of the aluminum-water feaction can be equal for the '059 slurry and the Faber slurry, depending upon the precise composition of the slurry and on the environmental conditions.

Equally important is the fact that there is no assertion by appellants, either in their brief or in the Ursenbach affidavit, that the calcium phosphate would not have protected the Faber slurry for a period of weeks or months had that been necessary. Ursenbach merely says (without any support) that Faber's slurry did not have to be protected in storage for several days or weeks. This is hardly the same thing as saying that Faber's slurry was not protected for several days or weeks by the addition of calcium phosphate.

Nor is it invention to discover that Faber's inhibition was longer than Faber may have needed for his particular purpose.

From the legal standpoint, appellants' argument in this connection must also fail. Not one of the five claims of the patent in suit sets forth a parameter or limitation relating to the time required for inhibition or the length of time between mixing of the slurry and commencement of the undesirable aluminum-water reaction. As this Court stated in Henderson v. A. C. Spark Plug Div. of General Motors Corp., 366 F. 2d 389 (9th Cir. 1966) at 393 fn. 5:

"The matter involved is in no way material. Neill testified that the Hanks flow-control valve [prior art device] operated in the opposite manner to that of Henderson [patent in suit] (Nov. 8 Tr. 46). While Neill was incorrect in his statement, the matter is of no moment. Claim 6 simply calls for a flow-con-

trol valve operable by engine induced vacuum. It does not require that the valve operate in any particular direction or manner. Thus, the 'issue' suggested by plaintiff is not a material one."

C. The Ursenbach Affidavit Fails to Raise Any Genuine Issue of Material Fact

Although relied upon by appellants as raising genuine issues of material fact, in actuality the affidavit fails to comply with Rule 56(e) F. R. C. P.* and is therefore totally useless and ineffective for this purpose.

The affidavit is devoid of admissible evidentiary facts upon which a court could base its own conclusions. Moreover, the paragraphs of the affidavit following the introductory material are replete with hearsay, conclusions of fact and of law, and ultimate facts. The final paragraph is clearly objectionable in that it states conclusions of law and goes to the fundamental issue between the parties. See Piantadosi v. Loew's Inc., 137 F. 2d 534 (9th Cir. 1943); Jameson v. Jameson, 176 F. 2d 58 (D. C. Cir. 1949); and United States v. Britten, et al., 161 F. 2d 921 (3d Cir. 1947).**

The glaring omission of relevant evidentiary facts from the Ursenbach affidavit was repeatedly pointed up during the oral hearing before Judge Real. [Tr 24-6 and 53]

УШ.

FINDINGS OF FACT 2, 3, 4, 6, 8 AND 10 ARE SUPPORTED IN THE RECORD

Appellants take issue only with Findings of Fact 2, 3, 4 and 6 and with conclusory Findings 8 and 10.***

^{*}Rule 56(e) F. R. C. P. is reproduced in the Appendix hereof.

**See also Shientag, Summary Judgment, 4 Fordham L. Rev. 188,
198 (1935) for an excellent discussion of the form and content of
affidavits for summary judgment motions.

***Findings 1, 5, 7 and 9 are expressly not challenged [P. Br. 9].

Finding 2 is as follows:

"The alleged invention of the '059 patent relates to a method of stabilizing aqueous slurries useful as blasting explosives, said slurries containing water, particulate aluminum and an oxidizing agent, e.g., inorganic nitrate, for the purpose of preventing a gas-evolving reaction between the aluminum and water, and specifically involves the addition to such aqueous slurries of an ammonium or alkali metal phosphate for such purpose."

Finding 2 is not criticized as lacking support in the Record.

Appellants contend that Finding 2 is inaccurate in stating that the invention of the patent in suit "relates to a nethod". The '059 patent itself, column 1, at line 50, states:

"The method of this invention comprises the addition of . . ."

Appellants further criticize Finding 2 as being incomplete and misleading by ignoring the fact that the patent claims an aqueous blasting slurry. As discussed in detail above, the end use of the slurry plays no part in the alleged invention of the patent. The alleged invention is fully described in the Finding. To distinguish one inhibited slurry from another slurry which is the same in all relevant aspects and which has been inhibited in the identical way, on the passis of the end use of the slurry, is to exalt form over substance.

Under the circumstances previously outlined, it is immaterial that Finding 2 does not include a statement relating to the fact that the slurries of the '059 patent are used for blasting purposes. The Finding sets forth the *invention*, and as such, it is complete.

Appellants further criticize Finding 2 in that the phosphates used inhibit the aluminum-water reaction over a period of weeks or months. As indicated above at pp. 38-40 hereof, this is factually irrelevant and also immaterial from the standpoint of law.

Finding 3 is as follows:

"The '059 patent does not attribute any criticality of uniqueness either to the particular phosphates disclosed and claimed therein to be suitable for such purpose, or to the amounts thereof to be used for such purpose."

Appellants criticize Finding 3 as lacking support in the Record and as being directly contrary to the description of the '059 patent and to statements in the Ursenbach affidavit

At page 26 hereof, there is a full and complete discussion of the lack of criticality in the particular phosphates taught in the '059 patent. At pp. 26-28 hereof, there is a full and complete discussion of the total lack of criticality in the range of amount of phosphates taught by the '059 patent From this it will be seen that the total absence of any as sertion in the patent or experimental evidence in the record to support such criticalities justifies a Finding that such criticalities do not exist.* This is reinforced by Faber' showing that other phosphates can be used for the very same purpose, and the '059 statement that more than the claimed amounts of phosphate may be used, if desired.

The Ursenbach affidavit notably lacks any evidence in the form of experimental data or otherwise which proves or shows that the amounts of phosphate or the types of phosphate used in the '059 patent are *critical*. There is no showing in the Ursenbach affidavit that other phosphates are

^{*}Whether or not they are "of importance" is irrelevant. See supr p. 14, fn.

noperative, nor is there any showing that amounts different from the range set forth in the '059 patent are inoperative.

Finding 4 is as follows:

"U. S. No. 1,529,778 (hereinafter referred to as the '778 patent) teaches the use of buffer salts, and in particular a phosphate salt, to inhibit the gasevolving aluminum-water reaction in an aqueous slurry composition containing water, particulate aluminum, and an inorganic nitrate."

Finding 4 is not challenged as lacking support in the record. According to appellants, this Finding is inaccurate because it ignores:

- (a) That Faber does not disclose an explosive composition;
- (b) That Faber does not teach the use of phosphates generally nor the claimed phosphates in particular, and
- (c) That Faber teaches the use of acid buffer salts to prevent hydrogen evolution by neutralizing alkalinity in the system.

The extensive discussion above makes it abundantly clear that these points raise irrelevant and immaterial issues.

Finding 6 is as follows:

"U. S. No. 2,481,795 (hereinafter referred to as the '795 patent) teaches that ammonium dihydrogen phosphate, sodium dihydrogen phosphate, and alkali metal phosphates in general were known buffer salts which could be incorporated in explosive compositions containing inorganic nitrate."

It is noted that appellants do not contend that Finding 6 is unsupported by the record.

Appellants contend that Finding 6 is inaccurate because it fails to state:

- a) That Taylor does not describe either an aqueous slurry or any composition containing aluminum, and
- b) That Taylor suggests acid phosphates only to neutralize alkaline vapors.

Taylor was cited solely to show that one skilled in the explosive art knew, at the time of the filing of the application for the '059 patent, that certain phosphates were useful as buffer salts in nitrate explosives. (supra, p. 6) The District Court fully understood this use of the Taylor reference. Accordingly, it is irrelevant that Taylor does not describe an aqueous slurry or a composition containing aluminum. That Taylor suggests his phosphates be used to neutralize alkaline vapors enhances rather than diminishes the relevance of this reference.*

Findings 8 and 10 are challenged by appellants as being "totally erroneous" [P. Br. 10]. As may be seen from the foregoing, these findings are fully supported by the record and the other findings based thereon.

^{*}Indeed, the ammonia evolved from the '059 slurry is an "alkaline vapor".

CONCLUSION

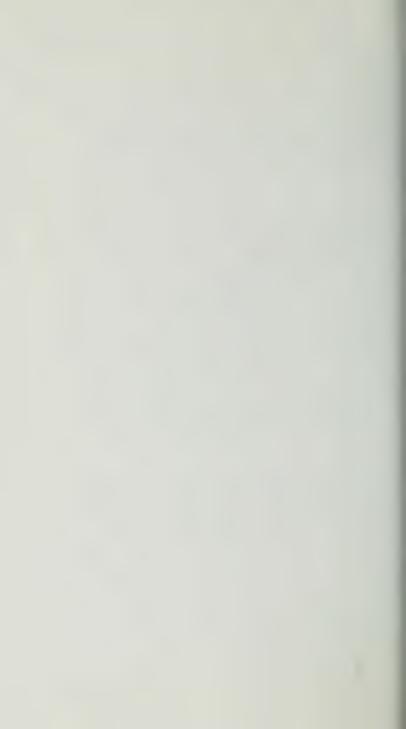
In view of the foregoing, U. S. Patent No. 3,113,059 is avalid under 35 U. S. C. § 102(b) and § 103, and the judgment of invalidity rendered by the Court below should be firmed.

Respectfully submitted,

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I certify that in connection with the preparation of this rief, I have examined Rules 18, 19 and 39 of the United tates Court of Appeals for the Ninth Circuit, and that, a my opinion, the foregoing brief is in full compliance with those rules.







APPENDIX

Rule 56, F. R. C. P.

- (b) For Defending Party. A party against whom a laim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in favor as to all or any part thereof.
- (c) Motion and Proceedings Thereon. The motion hall be served at least 10 days before the time fixed for the learing. The adverse party prior to the day of hearing may erve opposing affidavits. The judgment sought shall be endered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the ffidavits, if any, show that there is no genuine issue as to my material fact and that the moving party is entitled to a sudgment as a matter of law. A summary judgment, interpotutory in character, may be rendered on the issue of lability alone although there is a genuine issue as to the mount of damages.
- (e) Form of Affidavits; Further Testimony; Delense Required. Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts is would be admissible in evidence, and shall show affirmaively that the affiant is competent to testify to the matters tated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affilavits to be supplemented or opposed by depositions, anwers to interrogatories, or further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his re-

sponse, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, shall be entered against him.

U. S. Code, Title 35, Patents

§ 102. Conditions for patentability; novelty and loss of right to patent

A person shall be entitled to a patent unless—

- (a) the invention was known or used by others in this country, or patented or described in a printed publication in this or a foreign country, before the invention thereof by the applicant for patent, or
- (b) the invention was patented or described in a printed publication in this or a foreign country or in public use or on sale in this country, more than one year prior to the date of the application for patent in the United States, or
 - (c) he has abandoned the invention, or
- (d) the invention was first patented or caused to be patented by the applicant or his legal representatives or assigns in a foreign country prior to the date of the application for patent in this country on an application filed more than twelve months before the filing of the application in the United States, or
- (e) the invention was described in a patent granted on an application for patent by another filed in the United States before the invention thereof by the applicant for patent, or
- (f) he did not himself invent the subject matter sought to be patented, or

(g) before the applicant's invention thereof the invention was made in this country by another who had not abandoned, suppressed, or concealed it. In determining priority of invention there shall be considered not only the respective dates of conception and reduction to practice of the invention, but also the reasonable diligence of one who was first to conceive and last to reduce to practice, from a time prior to conception by the other.

§ 103. Conditions for patentability; non-obvious subject matter

A patent may not be obtained though the invention is not dentically disclosed or described as set forth in section 102 of this title, if the differences between the subject matter cought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains. Patentability shall not be negatived by the manner in which the invention was made.

§ 282. Presumption of validity; defenses

A patent shall be presumed valid. The burden of estabishing invalidity of a patent shall rest on a party asserting t.

The following shall be defenses in any action involving he validity or infringement of a patent and shall be pleaded:

- (1) Noninfringement, absence of liability for infringement, or unenforceability,
- (2) Invalidity of the patent or any claim in suit on any ground specified in part II of this title as a condition for patentability,

- (3) Invalidity of the patent or any claim in suit f failure to comply with any requirement of sections 1 or 251 of this title,
- (4) Any other fact or act made a defense by the title.

In actions involving the validity or infringement of patent the party asserting invalidity or noninfringeme shall give notice in the pleadings or otherwise in writing the adverse party at least thirty days before the trial, of the country, number, date, and name of the patentee of an patent, the title, date, and page numbers of any publication to be relied upon as anticipation of the patent in suit of except in actions in the United States Court of Claims, showing the state of the art, and the name and address any person who may be relied upon as the prior inventor as having prior knowledge of or as having previously used or offered for sale the invention of the patent in suit. In the absence of such notice proof of the said matters may not made at the trial except on such terms as the court required

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

Appeal No. 22,142

TERMOUNTAIN RESEARCH AND ENGINEERING COM-PANY, INC., IRECO CHEMICALS, AND IRON ORE COM-PANY OF CANADA,

Plaintiffs-Appellants,

v.

ERCULES INCORPORATED AND KAISER STEEL CORPORATION,

Defendants-Appellees.

REPLY BRIEF OF PLAINTIFFS-APPELLANTS

FILED

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UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

NTERMOUNTAIN RESEARCH AND ENGINEERING COMPANY, INC., IRECO CHEMICALS, AND IRON ORE COMPANY OF CANADA,

Plaintiffs-Appellants,

HERCULES INCORPORATED and KAISER STEEL CORPORATION,

Defendants-Appellees.

Appeal No. 22,142

REPLY BRIEF OF PLAINTIFFS-APPELLANTS

It is apparent from the brief of defendants-appellees that the following matters are not in dispute:

- 1. Jurisdiction of the District Court.
- 2. Jurisdiction of this Court.
- 3. The Faber patent, No. 1,529,778, and the Taylor, et al patent, No. 2,481,795, constitute the entire prior art relied upon by appellees, the moving party.
- 4. The Faber patent describes a non-explosive sparkler mix applied to, and dried on, wires for children to use in celebrating the Fourth of July.
- 5. The Taylor patent is not concerned with an explosive slurry, nor does it mention any explosive that contains either water or aluminum.
- 6. The Ursenbach, et al patent in suit, No. 3,113,059, is not anticipated by Taylor.

There are only two real issues on this appeal. They are whether on this record, and without a trial or the benefit of expert testimony, this Court can say:

- 1. that the claims of the patent in suit are "anticipated" under 35 U. S. C. § 102(b) by Faber, or
- 2. that the claims of the patent in suit were obvious in 1964 to one skilled in the explosive art from the combined teachings of Faber and Taylor.

Appellees' brief does not attempt to meet either of these issues squarely. Instead, appellees' brief talks superficially about "inventive concept" (pp. 15-18), "the problem" and "the solution" (pp. 24-25), "patentable distinction", "patentable significance" and "original thinking" (pp. 26-29), the lack of correctness of the prior art theory (pp. 34-36), and whether the trial court's findings are supported by the record (pp. 40-44).

Appellees' very failure even to discuss the language and substance of the *claims* of the patent in suit demonstrates at once the weakness of their position. We shall deal first with these two basic issues, and then comment on appellees' erroneous, but merely peripheral, attacks.

The Patent Claims Certainly Are Not Anticipated By Faber

Appellees' brief argues at pages 24 to 30 that the patent in suit is "anticipated" by the prior Faber patent.

Appellees have cited no authority supporting a finding of anticipation under 35 U. S. C. § 102(b) (even after a trial) where there is not identity or complete equivalence between what is described in the prior art and what is claimed in the patent in suit. Appellees' attempt to distinguish this Court's decision in Stauffer v. Slenderella Systems of California, 254 F. 2d 127, 128 (9 Cir. 1957) in the footnote on page 28 of its brief assumes a state of facts that is not so. Appellees' brief pointedly disregards

he following more recent language of this Court on this ery point in *Walker* v. *General Motors Corporation*, 362 '. 2d 56, 58 (9 Cir. 1966):

"As to claims 1 and 2, defendants contend that the defense of anticipation was established despite the difference relied upon by plaintiff, because the separate and the single-unit constructions are equivalent. But plaintiff tendered evidence that the difference in physical construction produced significantly different results from the point of view of safety and ease of repair. Compare United States v. Adams, 383 U. S. 39, 86 S. Ct. 708, 15 L. Ed. 2d 572 (1966). Since the issue of equivalence could not be determined without resolving these disputed questions of fact, we conclude that as to claims 1 and 2 summary judgment on the grounds of anticipation was not appropriate.* [Citing cases.]"

Lack of identity between the *claims* of the patent in suit nd the description of Faber is perfectly clear from the ollowing facts which appellees' brief does not deny but ries to brush aside as "immaterial".

- 1. Faber does not teach, suggest, or describe a composition that is either a blasting agent or an explosive sysem, whereas, all claims of the patent in suit specify either 'An aqueous slurry blasting agent' or "An aqueous explosive system".
- 2. Faber does not teach, suggest, or describe any composition containing an ammonium or alkali metal phosphate calcium is not an alkali metal). All claims of the patent in suit specify "a phosphate selected from the group conisting of ammonium and alkali metal phosphates".

The foregoing differences (as well as others pointed out n our main brief at pages 6, 7, 15 and 16) are more than mmaterial word or semantic differences, as appellees argue.

^{*} Emphasis added unless otherwise indicated.

Appellees' brief throughout argues that the "problem" faced by the patentees and by Faber was the same. This is patently untrue.

The problem faced by the patentees Ursenbach and Udy was a problem dealing specifically with aqueous slurry blasting explosives that contained over 50% of ammonium and sodium nitrates, 8 to 20% of aluminum and about 10 to 15% of water. The patent states (R 83, col. 2, 11. 54-55) that such slurries "showed excessive gassing after storage at room temperature for two weeks." The problem, therefore, was to inhibit this gassing without interfering with the subsequent effectiveness of these slurries as blasting agents or explosives. Here again, the patent in suit is specific, stating that when very small amounts of certain named phosphates were added to these slurries (R 83, col. 2, 11. 60-64):

"The resulting inhibited slurries were stored for three months without evidence of gassing. The stored slurries were fired in six inch boreholes with 160 gram pentolite boosters. All charges fired satisfactorily."

The patent in suit states that one of its objects (R 83, col. 1, ll. 46-49) is to provide stable aluminum-containing aqueous slurry blasting agents "which may be stored for extended periods without decomposition". Decomposition of the aluminum obviously would interfere with the subsequent use of these products as blasting agents.

Faber's problem was entirely different. Faber was concerned with a non-explosive thick syrup of dextrin (a sugar) in water to which was added aluminum powder finely divided iron and steel filings, barium nitrate and magnesium carbonate in unspecified amounts. This mix was said to "bubble and boil", foaming up over the top of the tub and generating a great deal of heat within a few hours after mixing. (Whether it occurred 3 or 6 hours after mixing is unimportant.)

Thus, even though in both cases there may, at some age, have been an evolution of hydrogen produced by faction of aluminum with water, the problems of Faber and of the patentees of the patent in suit were manifestly of the same. As appellees well know, the aqueous slurry lasting agents of the kind claimed in the patent in suit o not "bubble and boil" nor require any inhibitor nor any featment to prevent gassing when they are to be exploded ithin 2 or 3 days after mixing.

Appellees' brief argues (pp. 38-39) that gassing ocurred with the patentees' slurries in 6 hours, but this is ot true in normal use. Example 1 of the patent, on which his misleading argument of appellees is based, is clearly tated in the patent to be a special accelerated gassing est carried out with special mixtures heated to 81°C. 177.8°F.), whereas the claimed blasting slurries in normal se are stated to be stored at "room temperature".

At the very least, the questions of whether the claimed lasting agents are equivalent to Faber's sparkler mix, nd whether the claimed phosphate inhibitors are the equivalent of Faber's different calcium mono acid phosphate, aise issues of fact which cannot be resolved by summary udgment.

In addition, the solutions proposed by the patentees and y Faber to their respective different problems involved undamentally different chemical reactions.

I. Faber Taught An Entirely Different Solution To His Problem And Failed To Teach The Solution Adopted By The Patentees

We have seen that the prior art Faber patent says it was dealing with a mixture that fermented, bubbled and coiled three to six hours after it was mixed. Whether ightly or wrongly, Faber attributed this fermenting to a hemical reaction between the aluminum and water in his nixture and pointed out that this reaction was accelerated by the alkalinity of his mix.

The teaching of Faber is that there are many factor in his particular mix which tended to make it alkaline. H speaks not only of ammonia but other by-products that ar also alkaline; the fact that the magnesium carbonate h used was noticeably alkaline; and the fact that sometime the tap water was alkaline (R 74, 11, 56-74).

Faber makes a special point of teaching that the spee of the reaction between finely divided aluminum and wate was increased with increased alkalinity (R 74, 11. 60-62).

Thus, Faber proposed as his solution use of what he calls a "buffer" to prevent or neutralize this alkalinity. It is perfectly plain from the statement of Faber quote on page 6 of our main brief that Faber considered a greamany acids and acid salts to be satisfactory for this neutralization, even though he mentioned calcium mono phosphat as "the best example" of such an acid salt.

The term "buffer" is seldom used alone by the chemis The first question asked is a "buffer" for what, or agains what? Any chemist knows that if an acid condition in system is to be buffered, the buffer should be alkaline in nature to neutralize the acid to be buffered. And, conversely, if an alkaline condition is to be buffered in a chemical system, the buffer to be used necessarily has to be of a acidic nature.

Appellees' brief quotes, in part (footnote, p. 5), the definition of the term "buffer" from the 1953 edition of "The Van Nostrand Chemist's Dictionary" at page 100. The complete definition in this dictionary is as follows:

"BUFFER. A substance that enables a system or entity to resist changes in conditions, mechanical shocks, addition of foreign substances, etc. As the term is most commonly used in chemistry, a buffer is a substance which, upon addition to a system renders the hydrogen ion concentration resistant to or less sensitive to, additions of acidic or alkaling substances. There are other chemical buffers, however, such as the oxidation-reduction buffer, which tends, in the same way, to stabilize the oxidation reduction potential of a system."

To a chemist, therefore, Faber's description proposes only the use of a mild acid or acid salt kind of buffer for the purpose of buffering by neutralizing the alkalinity in, or developed in, his sparkler mix. Faber recommended balcium mono acid phosphate as one acid salt particularly suitable to buffer, by neutralizing, the alkalinity in his mix. There is not one word in Faber's description to suggest that this particular acid salt is effective because it is a phosphate. Most important, there is no suggestion whatsoever in Faber's description that other phosphates (acid or alkaline) would prevent the bubbling and boiling of Faber's sparkler mix.

Faber's total teachings are summarized in his three claims (R 75) which state that a buffer is added "in such amount as to maintain an acid reaction to the mass" (claims 1 and 2), and that a material having an acid reaction is added in sufficient excess "to impart a distinct acid reaction to the entire mixture." (claim 3).

The patentees simply did not follow this teaching of the prior Faber patent in their use of different phosphates, regardless of whether they were acid or alkaline. For example, trisodium phosphate given as one example in the patent in suit (R 83, col. 2, 11. 57-58) is a notoriously alkaline salt and exactly the type of compound that should not be used to buffer alkalinity, according to Faber's teaching.

Appellees' brief (p. 35) suggests that maybe Faber's theory was wrong. This is indeed a bootstrap argument because we are here concerned only with what Faber's description taught the art, not with what might have been. This entire argument is founded on the absurdly incorrect premise (p. 36) that Faber's sparkler mix would today infringe the claims of the patent in suit, and that that which if later infringes, if earlier, anticipates. Faber's mix is not a blasting agent or explosive system and does not contain one of the claimed phosphates. Neither anticipation nor infringement of these claims is involved, as we have already shown (supra, pp. 2-5).

Appellees' arguments along this line are the kind of argument that applies only where one is trying to repatent an old composition. That is not true here where there is no anticipation, there has been no attempt to repatent Faber' old sparkler mix, and the issue comes down to the question of obviousness under 35 U. S. C. § 103.

Faber teaches the use of a mild acid or acid salt to buffe the alkalinity of his sparkler mix until this mix can be coated on iron wires and dried. The patentees on the other hand discovered and claimed that a certain class of phos phates, not even suggested by Faber, stabilize their slurry blasting agents for storage—as wet slurries—for periodup to three months.

These are different solutions to different problems and appellees' argument as to chemical equivalence immediately injects issues of material fact that cannot properly be resolved on summary judgment.

III. The Claimed Invention Of The Patent In Suit Wa Not Obvious From The Teachings Of Faber And Taylor.

Appellees' argument on obviousness (pp. 30-33), stated baldly and simply, is that it was obvious to use the phosphates mentioned by Taylor as the buffer salt in Faber's mix.

One complete answer to such an argument is that the mere substitution of Taylor's phosphate as the acid sal buffer in Faber's sparkler mix would still not anticipat a single one of the claims of the patent in suit. Faber' mix with such a substitution would still not be a slurry blasting agent or explosive system as claimed.

Another complete answer to this argument of appellee is that the total combined prior art teaching of both Fabe and Taylor is the use of an acid salt to buffer alkaimity whereas the patentees do not utilize any buffering action a shown by the affidavit of Ursenbach (R 121-2).

Appellees complain bitterly (pp. 3, 34, 35) that the patent in suit does not explain any theory as to why the claimed phosphates act to stabilize the slurry blasting agents during storage. It is, of course, axiomatic that a patentee does not have to have a theory or even to understand why or how his invention works. The important point, as we explained fully on pages 21 and 22 of our main brief, is that the patentees' phosphates cannot possibly function as acidic buffers to neutralize alkalinity. They work because they are phosphates, not because they are the acid salt buffers of alkalinity taught by Faber and Taylor.

On this point, the affidavit of Ursenbach is specific (R 121-2). Appellees' attack (pp. 7-8) on his qualifications as an expert is absurd (*infra*, p. 14).

Appellees repeatedly get the cart before the horse in arguing (pp. 4, 26, 34, 39) that there is nothing in the record to prove that Faber's calcium mono acid phosphate would be inoperative to stabilize the patentees' slurry blasting agents. If appellees, as the moving party, wanted to contend that Faber's acid salts, including calcium mono acid phosphate, would stabilize blasting slurries, they should have produced evidence to this effect. Appellees were the moving party.

Appellees are not in any position to ask this Court to assume, without a shred of supporting evidence, that calcium mono acid phosphate would be as effective as the phosphates specified in the patent claims, or even that this particular phosphate would be effective at all in the claimed blasting slurries. Appellees well knew that the mere offering of any such evidence by them would immediately raise a material fact issue precluding any decision by summary judgment.

A. The Taylor Patent Has Absolutely Nothing To Do With The Invention Claimed In The Patent In Suit

Appellees' brief admits (pp. 6, 30, 44) that the prior Taylor patent was cited only to show that certain phosphates had been used as buffer salts in nitrate explosives.

Appellees do not deny, however, that Taylor was dealin with a dry explosive that did not contain either aluminum or water and, therefore, could not have possibly involve any chemical reaction of aluminum and water. Taylor description on its face has absolutely nothing to do wit the use of phosphates to inhibit or buffer a chemical reaction between aluminum and water.

The only references to phosphates in the Taylor pater are in column 3, lines 60-69, and column 4, lines 21-2 (R 77). Here, Taylor was talking about a possible reactio between ammonium salts and the metal carbonate in hi dry explosive and suggesting the use of certain acid phosphates only, or a "non-alkaline mixture" of such salts, to neutralize alkalinity. The teaching of Taylor may have some remote connection with the teaching of Faber in neutralizing alkalinity, but that is not what is claimed in their patent by the patentees.

Appellees' brief says (p. 25) "It is undisputed by appe lants that diammonium hydrogen phosphate and alka metal phosphates are buffers." This is absolutely wrong Neither Faber nor Taylor mentions or suggests the use of diammonium hydrogen phosphate in any explosive or other composition, nor do either of these prior patents say that this compound is a buffer for anything. Diammonium hydrogen phosphate is the preferred stabilizer of the par entees specified in claims 3 and 4 of the patent in suit. W repeat, this compound is neither mentioned nor suggeste by either Faber or Taylor. This compound is alkaline i nature and could not serve as a buffer for alkalinity in a aqueous chemical system. What the Taylor patent doe mention is ammonium dihydrogen phosphate which is acidi in nature (because it contains more hydrogen than ammo nium). All that Taylor taught the art was the use of certai acid phosphates to neutralize alkalinity in a substantiall dry system devoid of aluminum.

Taylor has nothing to do with either an aluminum-wate reaction or aqueous blasting slurries.

V. Appellees Have The Burden Of Proving Invalidity Of The Patent In Suit And The Presumption Of Validity Is Not Destroyed

Appellees' brief argues (p. 23) the patent in suit has no presumption of validity and any presumption was "destroyed" by "the existence of pertinent prior art not cited by the Patent Office".

35 U. S. C. § 282 not only states that a patent should be presumed valid, but also that the burden of establishing invalidity rests on the party asserting it. Appellees' argument is based on appellees' assumption that Faber and Taylor are more pertinent than the prior art cited by the Patent Office. Appellants do not agree that this assumption is correct and, therefore, appellees' assumption at the outset raises a material issue of fact precluding summary judgment on this premise.

Furthermore, even if Faber and Taylor were more pertinent, it does not follow that the presumption of validity is 'destroyed'. The authorities cited in appellees' brief do not support this argument, and we know of no decision of this Court, or of any other Circuit Court of Appeals, that goes that far.

This is simply another cart-before-the-horse effort by appellees to avoid their own burden of proving invalidity, if they can, and to try to shift that burden to appellants. Of course, the presumption of validity is rebuttable. But on the record before this Court, no evidence has been offered by appellees which rebuts it.

V. No Merit In Appellees' Criticism Of Appellants' Statement Of The Case And Of The Deficiencies In The Trial Court's Findings

Appellants reiterate that the District Court findings and conclusions are based entirely on the Court's own interpretation of the patent in suit and the prior art patents cited. Furthermore, the findings do not mention and, there fore ignore, the Ursenbach affidavit. This Court can se from the transcript what was said at the oral argument of this patent, and we believe the foregoing statements are entirely justified by that transcript.

The findings adopted by the District Court, like th arguments in appellees' brief, are an oversimplification of the issues involved. Wherever appellees cannot meet the point, it is said to be immaterial. For example, appellees say (p. 14) the findings "are as complete as is necessary" (p. 26) "there is no criticality" in selecting the claimed phosphates; (p. 27) the exact amounts of the phosphate claimed is unimportant; (pp. 34-35) "the mechanism of inhibition is not an issue"; and (pp. 35-36) whether Faber understood his own prior art theory is "immaterial".

The findings of the District Court amount to an improper resolution, without trial, of complicated issues of chemical facts. Neither the Court nor trial counsel for either side was in a position of expert witness on this summary judgment motion.

VI. Appellees' Arguments Are A Succession Of At tempts To Avoid The Burden On The Moving Party

The law of this Court, as in all the other Circuits, is that a party moving for summary judgment has the burder of proof, and that the "slightest doubt" as to the facts of conclusions to be drawn from them require denial of the motion.

In Cox v. American Fidelity & Casualty Co., 249 F. 26 616 (9 Cir. 1957), the Court said (pp. 618-19):

"The summary judgment procedure under Rule 50 has been widely commented upon by all the circuits but perhaps the best statement on the applicability of the rule was made by the late Judge Jerome Frank of the Second Circuit, when he elaborated on the 'slightest doubt' rule enunciated by the First Circuit as follows:

""We take this occasion to suggest that trial judges should exercise great care in granting motions for summary judgment. A litigant has a right to a trial where there is the slightest doubt as to the facts, and a denial of that right is reviewable; but refusal to grant a summary judgment is not reviewable. Such a judgment, wisely used, is a praiseworthy time-saving device. But, although prompt dispatch of judicial business is a virtue, it is neither the sole nor the primary purpose for which courts have been established. Denial of a trial on disputed facts is worse than delay."

The district courts would do well to note that time has often been lost by reversals of summary judgments improperly entered.' Doehler Metal Furniture Co. v. United States, 149 F.2d 130, 135.''

Although appellees are the moving party, the argunents on many points in their brief are founded upon assumption and innuendo, not proof.

For example, appellees' brief (pp. 4, 16-17) argues that the patent in suit does not involve aqueous slurry blasting compositions per se. This argument, of course, ignores the plain language of the claims of the patent. The cologuv quoted in appellees' brief at page 17 does not support the argument. It is true that Ursenbach, et al. patent No. 3,113,059 is not the basic patent in this suit on the aqueous blasting slurries or explosives. The basic patent in suit on these explosives is the Cook, et al. patent, Re-25,695 (R 91-94). It is also true that the phosphates claimed as part of the aqueous blasting slurry compositions in the '059 patent do not make such slurries better blasting agents. But, as the trial court was told, neither do these phosphate additions make these compositions poorer blasting agents and that is a result which one skilled in the art could never learn from studying the Faber or Taylor patents because neither of these prior patents was dealing with an aqueous slurry blasting agent containing aluminum.

Another innuendo argument in appellees' brief (pp. 3-426) is that the '059 patent in suit does not give any data as to why only certain phosphates were disclosed and claimed as stabilizers. This overlooks paragraph 3 of the Ursenbach affidavit (R 121) showing that out of the many materials tried, these particular phosphates worked best But, more important, appellees have the burden of establishing positively that this is not critical, if they wis to argue this point as part of their case on a motion for summary judgment.

Furthermore, the decision of Judge Barnes in Stallmary. Casey Bearing Company, 244 F. 2d 905 (9 Cir. 1957) cite by appellees (p. 26) does not support appellees' argument Judge Barnes, in that case, held certain details were not critical because they were not disclosed or claimed in the patent. Appellees are arguing as not critical the specific phosphates, and the specific amounts of those phosphates that are specifically disclosed and claimed in the patent is suit.

Appellees' attacks on the Ursenbach affidavit (brief pp. 7-8, 35, 40) are of the shot-gun type. First, the aff davit (R 121) shows that Ursenbach holds an M.S. degre in chemistry, did three years of graduate work in physical chemistry, worked for nine more years in research in the explosives field, and for the next six years was an Associat Professor at the University of Utah and also worked or research and development in the field of aqueous types of slurry explosives. We believe this qualifies him as a expert.

The remainder of his affidavit states chemical facts an opinions which he will be fully qualified to state as a witnes in court. Appellees submitted no evidence or affidavit denying the statements and opinions of Ursenbach, a though they had ample opportunity to do so in the tria court. Appellees' attacks on the Ursenbach affidavit i this Court have no merit whatsoever, and are certainly n substitute for any proofs that appellees had the burde of offering, but failed to offer, in support of their motion

VII. Appellees' Arguments That Reaction Conditions Are Identical, And That The Mechanism Of Inhibition Is Not An Issue, Raise Issues Of Fact Going To The Very Heart Of The Motion

Appellees' brief (pp. 37-8) argues that the reaction conditions of the patent in suit and of Faber's sparkler mix are dentical, (pp. 34-5) that any difference in the mechanism of publication is not an issue, and (p. 33) that what the patentees lid was add "a phosphate buffer salt". Ursenbach in his affidavit (R 121-122) states that the phosphates the patentees found successful "are not added to our slurry exploitives for the purpose of chemically neutralizing alkaline naterials in the slurry", and that he is convinced, as an expert, that the phosphates used as inhibitors in accordance with his patent "do not perform their inhibiting function by eason of any buffering action."

We have already shown (*supra*, pp. 4-8) that the reaction conditions of Faber and of the patentees are far from dentical. In Faber, an acid salt is used as a buffer to neuralize alkalinity in the mix. In the slurry explosive of the patentees, there is no alkalinity to be neutralized and the nhibitors claimed in the patent include phosphates that by heir very chemical nature could not possibly serve as a 'buffer' to neutralize alkalinity. If one thing is clear on his record, therefore, it is that the phosphates claimed by the patentees are effective not because they are acid salt ouffers, but because they are phosphates.

Faber nowhere suggests to a chemist that his mild acids, acid salts, or the specific compounds he mentions, sodium acetate and calcium mono acid phosphate, are effective because they are phosphates. If any conclusion is to be drawn on this record, it must be that the use of the phosphates claimed by the patentees was not taught by, and was not obvious from, the "buffer" teachings of the prior art Faber and Taylor patents.

CONCLUSION

The Judgment holding patent in suit 3,113,059 invaliand dismissing the Complaint as to said patent should be reversed with an award of costs to appellants.

Respectfully submitted,

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I certify that, in connection with the preparation of his brief, I have examined Rules 18, 19 and 39 of the linited States Court of Appeals for the Ninth Circuit, and tat, in my opinion, the foregoing brief is in full compliance with those rules.

M.P. Chu chilf

United States Court of Appeals

For the Ninth Circuit

PENNALUNA & COMPANY, INC. BENJAMIN A. HARRISON, and HARRY F. MAGNUSON,

Petitioners.

V.

SECURITIES EXCHANGE COMISSION,

Respondent.

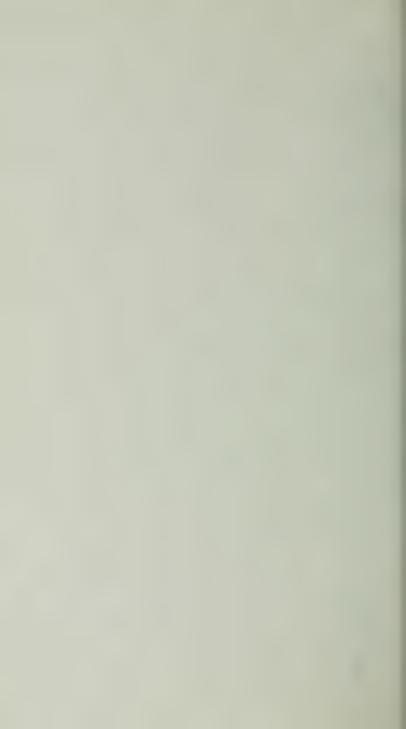
PETITION FOR REVIEW OF ORDER OF SECURITIES EXCHANGE COMMISSION

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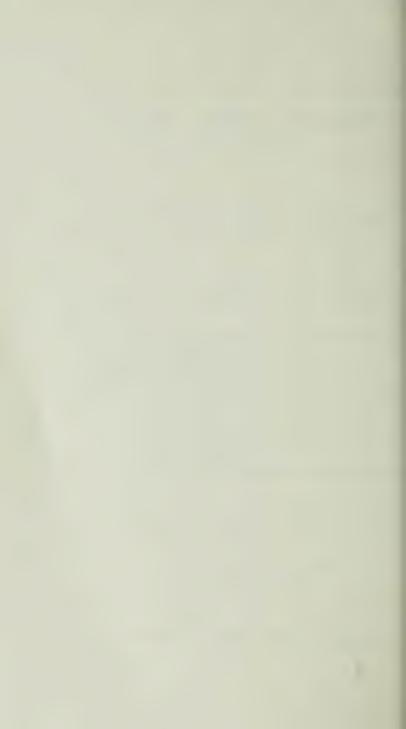
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BRIEF OF PETITIONERS PENNALUNA & COMPANY, INC. BENJAMIN A. HARRISON, and HARRY F. MAGNUSON

Ţ.

JURISDICTIONAL STATEMENT

This case is before this court on a joint petition filed on behalf of Pennaluna & Company, Inc., Benjamin A. Harrison, and Harry F. Magnuson for review of an order of the Securities & Exchange Commission dated April 27, 1967, revoking the registration of petitioner Pennaluna & Company, Inc. barring petitioner Benjamin A. Harrison and petitioner Harry F. Magnuson from association with any broker or dealer, and expelling petitioner Benjamin A. Harrison from membership in the Spokane Stock Exchange, and on the petition of the same parties for review of the order of the Securities Exchange Commission (hereinafter referred to as respondent) dated July 6, 1967, denying petitioners' joint petition for reconsideration. The order of the respondent dated April 27, 1967, appears at page 4608-4622 of the Record herein and the order of the respondent dated July 6, 1967, is found on pages 4661, 4662 of the Record herein. On September 1, 1967 an additional petition and motion for further rehearing, reconsideration and review was filed by petitioners; it was rejected by the respondent on September 12, 1967. (Supp. R. 4690-4699).

This action was commenced by an order for private proceedings issued by the respondent on October 1, 1964. (R. 65-71).

This court has jurisdiction to entertain this petition under the provisions of Section 25 of the Securities Exchange Act. (15 USCA 78y). Section 25 provides in part as follows:

Section 25. (a) Any person aggrieved by an order issued by the Commission in a proceeding under this title to which such person is a party may obtain a review of such order in the Court of Appeals of the United States, within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of

such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part.

Petitioner Benjamin A. Harrison is a resident of the City of Spokane, State of Washington. Petitioner Harry F. Magnuson is a resident of the City of Wallace, State of Idaho. Petitioner Pennaluna & Company, Inc. is a registered broker-dealer and has its principal place of business in the City of Spokane, State of Washington. The residence and principal place of business of each of the petitioners is found within this circuit. The petition for review was presented timely within 60 days after the entry of the final order of the respondent dated July 6, 1967.

The statutes involved in this action include Section 5 and Section 17(a) of the Securities Act of 1933 (15 U.S.C.A. 77e, 77q) and Sections 10(b), 15(b), 15 (c)(1), 19(a)(3) of the Securities Exchange Act of 1934 (15 U.S.C.A. 78j, 78o, 78s) and the rules of the respondent promulgated thereunder.

The order for private proceedings alleges violations of the above statutes in offering to sell, selling and delivering after sale the common stock of Silver Buckle Mining Company, an Idaho corporation, during the period from about May 8, 1962 to about June 10, 1963, and the common stock of West Coast Engineering, Inc., a Washington corporation, into which Silver Buckle Mining Company was merged on June 10, 1963, during the period from about that date to about April 30, 1964. (R. 68-70). It is further

alleged that the petitioners extended credit to certain customers in contravention of Section 4 (c) (2) of Regulation T promulgated by the Board of Governors of the Federal Reserve System and failed to make and keep current certain records required by Section 10(a) and Section 17(a) of the Securities Exchange Act (15 U.S.C.A. 78j, 78q) and rules of the respondent promulgated thereunder. (R. 69-71).

The record in this matter includes depositions of the petitioners and other witnesses together with exhibits submitted on behalf of the petitioners, witnesses and the respondent at each deposition. The record further includes a stipulation of facts entered into between the petitioners and members of the Division of Trading and Markets of the respondent on June 4, 1965, which stipulation was entered into for the purpose of providing the respondent with a basis for determining the evidentiary questions in this proceeding and for the further purpose of eliminating the need for a hearing to take evidence on the question set forth in Section 3 of the order for private proceedings. (R. 65-71). It was further understood in said stipulation that it included all the various exhibits, transcripts of testimony and related exhibits. (R. 129). The following facts were admitted by petitioners (R. 130-131): (1) the jurisdictional basis for applying Section 5 and Section 17(a) of the Securities Act, and Section 10(b) and 15(c)(1) of the Securities Exchange Act and the rules promulgated by respondent thereunder; (2) that petitioners did transact a business in securities through the medium of members of national securities exchanges, (3) that the petitioner Pennaluna & Company, Inc., (and its predecessor Pennaluna and Company) is a registered broker-dealer in securities pursuant to Section 15(b) of the Securities Exchange Act (15 U.S.C.A. 780).

II.

STATEMENT OF THE CASE

The Pennaluna & Company was registered with the respondent as a broker-dealer partnership pursuant to Section 15(b) of the Securities Exchange Act of 1934 (15 U.S.C.A. 780) on September 1, 1954 and continued in that capacity until January 16, 1964. (R. 136). From December 26, 1961 forward the partnership consisted of the petitioner Benjamin A. Harrison and the petitioner Harry F. Magnuson with Harrison owning a 62½ percent interest and Magnuson owning the remaining 37½ percent. (R. 136). On September 16, 1963, the petitioner Pennaluna & Company, Inc. (hereinafter referred to as "Pennaluna") was incorporated in the State of Idaho and, since that time, the petitioner Benjamin A. Harrison (hereinafter referred to as "Harrison") has been the president of Pennaluna. (R. 137). The petitioner Harry F. Magnuson (hereinafter referred to as "Magnuson") continued as its Secretary-Treasurer until August, 1965. (R. 137; R. 22). As shown by the amendment to the broker-dealer application received by the respondent on August 27, 1965, Harrison owned all the common stock of Pennaluna at that date. (R. 22). The registration of Pennaluna in its corporate form became effective on November 29, 1963. (R. 40).

During the time that Magnuson was an officer and director of Pennaluna, he supervised the Wallace and Kellogg offices, excluding the trading activities, and was responsible for the record-keeping activities of Pennaluna conducted at the Wallace office. (R. 152). Harrison was in charge of all trading activities of Pennaluna and the operation of the Spokane office. (R. 152). Pennaluna primarily deals in securities issued by mining companies with mineral properties in Idaho, Montana, Utah, Washington and British Columbia, and trades such securities for the most part on a wholesale basis with other broker-dealers and only to a lesser degree with retail customers. (R. 140).

Silver Buckle Mining Company

Silver Buckle Mining Company (hereinafter referred to as "Silver Buckle") was incorporated under the laws of the State of Idaho in 1947 with a capitalization of 10 million shares of non-assessable stock, having a par value of 10 cents. (R. 2185). Dr. Frank E. Scott, a dentist residing in Wallace, Idaho, has been involved in numerous mining ventures and was instrumental in the incorporation of Silver Buckle. (R. 157). On January 8, 1954, 378,333 shares of Silver Buckle were issued to Oil, Inc., (hereinafter referred to as Oil, Inc.) a company of which Mr. W. H. H. Cranmer was president at that time. (R. 4316-4319)

and R. 2194). Mr. Cranmer was also president of New Park Mining Company (hereinafter referred to as "New Park") and East Utah Mining Company (hereinafter referred to as "East Utah"), and Mr. Clark L. Wilson was Vice-President and Manager of operations of New Park and Superintendent of East Utah; as shown on an offering circular, New Park and East Utah owned 378,334 and 378,333 shares respectively of the common stock of Silver Buckle as of April 3, 1954. (R. 2194). These purchases were all made under stock options previously granted to Cranmer. (R. 2198). On that date, Dr. Frank Scott and Mr. Jack Gay jointly held 390,000 shares of Silver Buckle; Dr. Scott individually owned 187,578 shares and Mr. Gay owned an additional 390,000 shares. (R. 2194). During 1953 and 1954 Silver Buckle entered into joint operating agreements with Vindicator Silver Lead Mining Company and entered into a development agreement with the Defense Minerals Exploration Administration. Silver Buckle also had acquired an assignment of certain mineral leases in Utah, adjacent to a recent uranium discovery. (R. 2198). These mineral leases were acquired from Oil, Inc., New Park and East Utah in exchange for 666,666 shares of Silver Buckle stock distributed equally among the three companies.

As stated in the report to shareholders dated October 25, 1956, Silver Buckle's mining claims adjoin the Vulcan Mine operated by American Smelting & Refining Company and Day Mines, Inc. (R. 2233).

Silver Buckle also was continuing its interest in the Vindicator Mine, located near Mullen, Idaho, whi adjoined the Lucky Friday Mine, now owned and operated by Heela Mining Company. (R. 2233). Silver Buckle was developing its interest in the big Indi Wash area of the Southern Utah Uranium field und an operating agreement with National Uranium Company. (R. 2233). Silver Buckle had acquired 160.0 shares of Lucky Mac Uranium Corporation (R. 2233). These assets, together with the other assets of Silver Buckle, had greatly increased and diversified. (2233A).

The annual report for Silver Buckle for the periending July 31, 1960 indicated that the uranium operations of Silver Buckle had been quite profitable during the ensuing four years. Uranium leases acquir on the Spokane Indian reservation had been sold Dawn Mining Company and were being operated that company pursuant to a contract with the Atom Energy Commission. (R. 2237). After reimburseme for its expenses and advancements. Silver Buckle profit to realize approximately \$112,000.00 from the sale of these leases. (R. 2237). The financial starment attached to the annual report indicated the Silver Buckle now held liquid assets in the form cash and marketable securities in excess of \$1 milli dollars. (R. 2238, 2239; R. 164).

7.459.243 shares were issued and outstanding in Jun 1961, (R. 2185), with approximately 3,500 shareholde (R. 1945). New Park and East Utah jointly held about

1,417,000 shares of Silver Buckle; Oil, Inc. still held 600,555 shares. Dr. Scott, Jack Gay and Nolan Brown held approximately 1,025,000 shares as a group. (R. 1946). Dr. Scott was president and director; Clark Wilson was Vice President, General Manager and director; Alden Hull was Secretary-Treasurer and director; W. H. H. Cranmer and Nolan Brown were also directors. (R. 2185; R. 163). An additional 2,000,000 shares were committed for issuance as a result of the West Coast agreement described below; consequently, as of November 11, 1961, 9,459,243 shares were considered issued and outstanding.

Magnuson and Harrison have never been officers or directors of Silver Buckle. Sometime during the above period, Magnuson received 542 shares of Silver Buckle; these were the only shares held beneficially by him until May 8, 1962 (R. 158). Magnuson was a director of Vindicator but it is stipulated that he took no part in the negotiations for the Silver Buckle-Vindicator development contract or the purchase by Silver Buckle of Vindicator stock. (R. 161).

West Coast Engineering, Inc.

West Coast Engineering, Inc., (hereinafter referred to as "West Coast") was incorporated by Mr. Bryan J. Dickinson on October 6, 1960. (R. 165; R. 2245). As shown by an offering circular filed with the Securities Exchange Commission on September 1, 1961, the original objective of the company had been the sale of earth moving and mining equipment in the states of

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Washington and Alaska; (R. 2241) however, the company began to emphasize the manufacture and lease of indoor, automatic archery lanes. (R. 2242). This new enterprise was publicized by newspaper and magazine articles, as shown by clippings in the West Coast scrapbooks. (Scrapbooks I and II). One installation consisting of 16 archery lanes had been completed on August 25, 1961, and had been leased for a period of seven years to a partnership composed of two directors of West Coast. (R. 165; R. 2242) (Scrapbook I). The administration office, warehouse and manufacturing facilities of the company were maintained at 2427 Sixth Avenue South, Seattle, Washington. (R. 2242). The offering circular further disclosed that the company had not obtained patents as yet for the integral portion of its automatic archery lanes and that it had no assurance that the company could successfully develop or market the patented product. (R. 2242). The directors of the corporation were Bryan Dickinson, Willard Dziuk, Ethel Crial, Clark Conrad, William Johnson and William Delbridge. (R. 2243).

Only a few shares were sold under this offering and, by mid-October 1961, West Coast had a serious need for further developmental funds. (R. 165). In an effort to obtain further financing, Dickinson contacted a number of persons and mining companies in Wallace, Idaho, who might be interested in providing venture capital. (R. 166). Harry Magnuson was among those persons contacted. (R. 166). Dickinson called at Magnuson's office, but Magnuson was too busy to discuss West Coast's financing problems with him. (R. 1132).

Dickinson eventually contacted Scott and Gay. As a result of the subsequent discussions between them and an investigation by Gay into the prospects for automated archery, an agreement was entered into between Silver Buckle and West Coast on November 10, 1961. (R. 2268-2275). Under the terms of that agreement, Silver Buckle advanced West Coast \$60,000.00, evidenced by a promissory note payable upon 90 days demand, with interest at the rate of 6 percent per annum beginning 90 days after date on a declining balance. The note was convertible to 30.000 shares of common stock of West Coast at the option of Silver Buckle and, in the event that Silver Buckle elected to so convert, they would then have the further option to acquire 150,000 shares of West Coast at the price of \$2.00 per share. (R. 2269, 2270). Silver Buckle also acquired the independent right to acquire 50,000 shares of West Coast and, in the event that such acquisition was made, Silver Buckle had the right to acquire an additional 250,000 shares of West Coast at \$2.00 per share on the same time schedule as established for the other option agreements. (R. 2270). By exercising its conversion rights, Silver Buckle would become entitled to one or more representatives on the board of directors of West Coast and have the eventual right to acquire a majority representation on the board. (R. 2271). Silver Buckle had the further option to exchange 1,999,998 shares of its capital stock for 285,714 shares of capital stock of West Coast. (R. 2273).

The agreement was executed by Dr. F. E. Scott, president of Silver Buckle, and Bryan Dickinson, president of West Coast. (R. 2274).

As a result of this agreement, Silver Buckle had the ability to acquire 92 percent of the stock of West Coast. As shown in a note attached to the financial statement for West Coast for the year ending December 31, 1961, and the two months ending February 28, 1962, Silver Buckle executed certain of the above options on February 6, 1962. Silver Buckle owned 54.5 percent of West Coast's stock as of that date. (R. 2266). Silver Buckle eventually purchased 88.41 percent of West Coast's outstanding stock.

In conjunction with this agreement, Gay became a participant in West Coast's business affairs and had the ability to co-sign West Coast's checks. (R. 168). Following the directors meeting held February 6, 1962, Scott, Hull and Brown were elected to West Coast's 5-man board; the other two directors were Dickinson and Dziuk. Dickinson continued as president of West Coast; Gay became Executive Vice President and Dr. Scott became Secretary. Nolan Brown also became Treasurer. Pursuant to resolution, the directors of Silver Buckle also agreed to guarantee all of West Coast's present and future contractual indebtedness. (R. 171).

The Silver Buckle stockholders letter, dated February 21, 1962, stated that Silver Buckle had purchased

a controlling interest in West Coast for an investment of \$160,000.00. (R. 172; R. 2309-2311).

It is stipulated that neither Magnuson nor Harrison knew of this agreement between Silver Buckle and West Coast until the stockholders letter was received. (R. 159 and R. 167). Magnuson testified that he had no interest in Silver Buckle and consequently was not involved in any of the discussions taking place between October, 1961, and February, 1962. (R. 1134). Except for the fact that Magnuson and Scott were both directors of Vindicator and Ruby Silver Mines, Inc., Magnuson had not had any business arrangements with either Scott or Gay. (R. 1128).

The Oil, Inc. Transaction

On March 2, 1962, W. H. H. Cranmer was removed as president and general manager of New Park (R. 4158-4161); he was also removed as president of East Utah, and his son Robert L. Cranmer, was removed as executive vice president of East Utah on May 3, 1962. (R. 4151). These actions were taken as a result of the acquisition of control of New Park and East Utah by Mr. Charles Steen during late 1961 and early 1962. (R. 174, 175 and 176). Mr. Robert L. Cranmer previously had been named president of Oil, Inc. by his father and he continued in that position. The new management of East Utah and New Park was unable to exert any control over his activities or the activities of his company. (R. 4168; R. 4158-4161; R. 4163-4167).

Robert Cranmer was able initially to retain the Cranmer family control of Oil, Inc. but he needed money to withstand the Steen attack. (R. 1982). The Silver Buckle shares were an obvious source of funds. The Minutes of a special meeting of the Board of Directors of Oil, Inc., held May 8, 1962 revealed that another purpose of the subsequent sale of Silver Buckle shares was to meet outstanding obligations of Oil, Inc. (R. 2371, 2372). Cranmer contacted Dr. Scott concerning the possibility of Silver Buckle purchasing the 600,555 shares of Silver Buckle stock owned by Oil, Inc. (R. 176; R. 1982). Dr. Scott and Cranmer worked out an arrangement for the sale of these shares by Oil, Inc. for 10c per share, or \$60,055.00. (R. 176). In a letter to the Seattle Regional Office of the respondent dated February 1, 1965, in response to a subpoena duces tecum, the treasurer of Oil, Inc. stated that the sale negotiations were conducted by telephone between the officers of Oil, Inc. and the officers of Silver Buckle. (R. 176; R. 2367). Having negotiated the sale, Dr. Scott approached Magnuson to see if he was interested in participating in the purchase. (R. 1983; R. 1138). Magnuson testified that he was totally unfamiliar with the details of the West Coast agreement and became interested in Silver Buckle only because of its potential as a silver company. (R. 1138). He further testified that he did not know that Silver Buckle's liquid assets had been committed to West Coast. (R. 1140). He had not seen the financial statement of West Coast for the period ending February 28, 1962. (R. 1145). Magnuson stated to Scott that he was nterested in purchasing a portion of these shares for nis own account and that he and Scott should contact others who might also be interested. Among the persons contacted was Harrison on behalf of Pennaluna. (R. 178; R. 1148).

The Silver Buckle shares were deposited by Oil, Inc. n escrow with the Wallace Branch of the Idaho First National Bank. (R. 176; R. 2373). Pursuant to the corporate resolution of Oil, Inc., Magnuson's personal account became the medium into which payments were deposited by the various purchasers. (R. 2371). The cotal amount of deposits having been made, a cashier's check for \$59,995.50 (the purchase price less collection charge) was remitted to Oil, Inc. on May 18, 1962. (R. 2382; R. 2389). The two certificates were broken down among the various persons who had deposited the money into the escrow account by the transfer agent for Silver Buckle upon written instructions from Magnuson. (R. 2366). Certificates in the name of Pennaluna were issued for 461,555 shares; it is stipulated that Pennaluna had a beneficial interest in only 90,555 shares. (R. 2366; R. 177). Pennaluna had issued a check for \$9,055.50 directly to the Idaho First National Bank, which required H. F. Magnuson's endorsement before being deposited in the escrow account. (R. 2378, 2379). Magnuson, and accounts for his children of which he was custodian, actually paid for 172,000 shares. (R. 178). Scott purchased 14,000 shares. (R. 178). The remaining 324,000 shares were divided among persons whom both Magnuson and Scott had contacted (R. 179, 180) (See list of purchasers, Appendix page 2).

The shares purchased by Pennaluna were placed in its trading account and, on a first-in first-out basis were sold in the normal course of trading by July 14 1962, at prices ranging from 13 cents to 20 cents per share. (R. 182; R. 2395, 2396).

The New Park-East Utah Transaction

A geologist had examined Silver Buckle's silver properties at the request of Charles Steen, and, during July or August, 1962, Steen informed Scott that Steen was going to have Scott removed as president of Silver Buckle. (R. 196). Meetings and conversations were held between Steen and Scott, but they were unable to resolve their differences. (R. 2010). New Park and East Utah prepared a complaint against Silver Buckle to be filed in the District Court of Salt Lake County, State of Utah; the complaint is dated August 17, 1962, and demanded that the plaintiffs be permitted to inspect the corporate books of Silver Buckle. (R. 4192, 4193). Steen also decided to commence selling blocks of Silver Buckle stock owned by New Park and East Utah through the Cromer Brokerage Company of Salt Lake City, Utah. (R 196). Silver Buckle refused to honor the transfer request made on August 22, 1962 for 222,222 shares. At Silver Buckle's request, the transfer was effected only upon receiving a legal opinion from the attorneys for New Park and Cromer Brokerage Company that New Park did not exercise a controlling influence upon Silver Buckle because of the dispute between the companies. (R. 196; R. 2183).

During the summer months of 1962, Ruby Silver Mines, Inc. was in the process of preparing a Regulation A public offering of its shares. Magnuson was a director of this company for the purpose of representing Pennaluna, an underwriter of the proposed issue. (R. 189). About the middle of September, 1962, Magnuson first became aware that New Park and East Utah, who were also principal stockholders of Ruhy Silver, might take legal steps to oppose the public offering of Ruby Silver shares. (R. 197). Magnuson testified that he had been a rather inactive participant in the affairs of Ruby Silver, had not attended a meeting and had not been involved in its organization. (R.1181). In order to protect Pennaluna's underwriting commission and Ruby Silver's public offering, Magnuson contacted David Clegg, the attorney for New Park and East Utah at that time, and, at Clegg's request, arranged a meeting of all parties in Spokane to discusse Dr. Scott's differences with New Park and East Utah. (R. 197; R. 1185; R. 1197). The general framework of the discussion had already been established by Scott and Steen. (R. 1195).

As a result of the meeting held in Spokane, Washington, September 29, 1962, between Magnuson, Clegg, Scott and Alden Hull, an attorney for Silver Buckle, a plan of settlement was evolved which called for two

separate contracts. The first contract was between Silver Buckle, New Park and East Utah, and the second contract again used Magnuson's name as purchaser, and New Park and East Utah, as sellers. (R. 198; R. 1394-1407). Silver Buckle agreed to repurchase 367,111 of its shares and the companies agreed to cancel various claims and demands among them, including the Ruby Silver dispute. The remaining 800,000 shares were sold under the second contract for 20c per share, (slightly less than the average offer quote on the Spokane Exchange on September 28, 1962, (R. 2441), or a total of \$160,000.00. Magnuson was concerned only with the latter contract. (R. 1206). At Magnuson's request, the handwritten form of this contract stated that New Park and East Utah warranted that the stock was not subject to any SEC restrictions. (R. 1214; R. 2592). Clegg, an attorney, also told Magnuson that the stock could be traded. (R. 1216). Hull and Clegg drew the agreement. (R. 1215).

Magnuson testified that he did not feel he could influence the management of Silver Buckle and that he was not the controlling person at this time. (R. 1218). He received a legal opinion from Piatt Hull, a Wallace attorney, on October 5, 1962; that opinion stated that Magnuson was not a person in direct or indirect control of Silver Buckle based upon his recent acquisitions of Silver Buckle shares, shares owned by his children and shares purchased by Pennaluna. (R. 1229; Appendix page 5). Dr. Scott further testified that the group controlling Silver Buckle in-

cluded Gay, the Browns, the West Coast directors and himself. (R. 2050). This group continued to control Silver Buckle until the merger of June, 1963. (R. 2051).

Dr. Scott previously had agreed to be responsible for the purchase of 300,000 shares and Pennaluna, through Harrison, had agreed to purchase 200,000 shares (R. 199, 200; R. 1427). The Scott commitment was confirmed by Magnuson by letter dated October 1, 1962, which set forth the due date and amount of Scott's payments. (R. 2608).

The Spokane National Bank, Spokane, Washington, was designated as the escrow agent; certificates for 700,000 shares were transmitted by New Park directly to the bank, together with escrow instructions. (R. 2609). Pennaluna purchased 100,000 shares with a check for \$20,000 to New Park and East Utah, signed by Magnuson with Harrison's authorization, at the completion of negotiations on September 29, 1962. (R. 199; R. 4194). A purchase of 100,000 shares on September 29, 1962, was reported properly to the respondent in its December questionnaire. (R. 253; R. 4320).

Various persons contacted by Dr. Scott eventually purchased a total of 220,000 shares. (R. 201) Magnuson actually purchased a total of 370,000 shares for himself and his custodian accounts of which 300,000 shares are still held by him as part of the shares now owned in the reorganized company. (R. 1212). Pennaluna purchased its remaining 100,000 shares by checks for

\$10,000 each, dated November 26, 1962 and January 14, 1963, and also paid its share of the escrow fee. (R. 278; R. 3029, 3030, 3031) (See list of purchasers, Appendix page 4).

After receipt of the certificate for the 100,000 shares during the latter part of October, Harrison entered the purchase in the trading ledger of Pennaluna in blocks of 20,000 shares each @ 21c per share, on November 1, 1962, November 2, 1962, November 30, 1962, December 3, 1962 and December 5, 1962; these shares were sold in the normal course of trading activity by Harrison during this period. (R. 2402, 2410, 2411). New Park was shown as the seller.

Representatives of the Seattle Regional Office conferred with Magnuson on January 10, 1963 and advised him that they had some questions concerning the control aspects of the purchase of Silver Buckle stock from New Park and East Utah. (R. 278, 279; R. 3014, R. 4613). Harrison knew the substance of this conversation. (R. 279) The second block of 100,000 shares was not entered in the trading ledger but was charged to the drawing accounts of Harrison and Magnuson on January 12, 1963, partially as a result of this discussion. The certificates, after release from escrow, were placed in a special envelope. (R. 279).

On about March 5, 1963, Silver Buckle sent a letter to Harrison and other brokers concerning the SEC investigation of Silver Buckle stock prices and sales of Silver Buckle stock acquired from New Park and East Utah in September, 1962. (R. 302; Appendix page 86). That letter stated that the sellers of the stock had relied upon the advice of their counsel that registration was not required and that neither the Securities Act of 1933 nor the Securities Exchange Act of 1934 imposed any restrictions upon trading in the presently outstanding shares of the company except for certain restrictions with respect to unnamed controlling persons. Commencing May 2, 1963, and continuing through June 18, 1963, Pennaluna purchased the 100,-000 shares charged to the drawing account of Harrison and Magnuson through a nominee, Jerry T.O'Brien, who received \$500.00 for his participation in these transactions; both partners received their proportionate interest in the proceeds of sale. (R. 319, 320). O'Brien was shown as the seller on Pennaluna's trading ledger. (R. 2434-2437).

Magnuson testified that the sale was made through O'Brien in order to segregate the transaction from the normal trading activities of Pennaluna, to complete the transaction for purposes of meeting capital gain requirements, and to hide the transaction from the other employees of Pennaluna. (R. 1360; R. 1366). It was the policy of Pennaluna to discourage trading activities by its employees. Magnuson further testified that he thought the discussion on January 10, 1963 related to the 300,000 shares that he had purchased from New Park and East Utah and which were still in escrow at the time of the discussion. (R. 1363). Those shares were deposited with the Peoples National Bank

of Washington as collateral for a loan on about January 10, 1963. (R. 279).

Harrison has never held securities for a personal investment of any kind. Magnuson handled all details of this transaction. (R. 871, 872).

West Coast Publicity and Financing Activity

The Burien, Washington archery range opened about September 1, 1961 amidst widespread publicity and newspaper coverage. (See material in Scrapbook I). The Lessor's interest in the lease was sold to Lease Equipment Co. for \$86,733.60 on September 17, 1962 with recourse against West Coast for any delinquent rental payments. (R. 203; 2619-2631).

West Coast began an intensive publicity campaign on or about August 15, 1962 to promote the opening of the Golden Arrow Archery Lanes, Denver, Colorado, on September 28, 1962. (R. 203; R. 2611). The Denver archery range attracted nation-wide attention, as did the subsequent openings of the archery lanes at Portland, Oregon (November 9, 1962), Downey, California (December 13, 1962), and Covina, California (December 31, 1962). (R. 204; R. 260). Each opening was followed by a three-week TV, radio and publicity advertising campaign. (See pages 48-64 of Appendix for a sample of the press kit.)

Newspaper articles appeared in the Denver Post, Rocky Mountain News (Denver), Southeast News (Downey) Downey Herald American, Portland Oregonian, Los Angeles Herald Examiner, Los Angeles Times, Kalamazoo, Michigan Gazette, Detroit Press and many other newspapers throughout the nation. (Scrapbook I, page 41, 42; Scrapbook II, page 5, 6, 25; Scrapbook III and IV). These articles appeared almost daily during the Fall of 1962 and early Spring of 1963.

Magazine articles appeared in the December, 1962 issue of International Management, (McGraw-Hill Publication) page 67 (Scrapbook I), September, 1962 issue of Popular Mechanics (Scrapbook II, page 5), December, 1962 issue of Western Machinery and Steel World (Scrapbook II, page 11) and other business and archery magazines. (Scrapbook III and IV).

Extensive publicity during this period also accompanied the opening of archery ranges by World Wide Indoor Automatic Archery Lanes, a competitor of West Coast, partially an archery range at Boise, Idaho. (Scrapbook II, page 27).

This publicity attracted the interest of numerous brokerage firms and financial houses; in response to inquiries, Gay sent brochures and other general information to representatives of Pacific Northwest Company, Cruttenden, Podesta & Miller, Blythe & Company, J. May & Company, Parks & Co., the research department of Bache & Company and several other firms. (R. 204; R. 1592; R. 1712; R. 2883; R. 4155; R. 4196-4210).

On October 13, 1962, an illustrated article concerning West Coast and the Denver opening appeared in Business Week. (R. 224; Scrapbook II, page 6). Gay testified that the article was the product of Dickinson and the West Coast public relations department and related directly to the Denver opening. (R. 1602). The article inaccurately referred to twenty million dollars worth of business; Gay recognized that the figure was inaccurate and requested West Coast salesmen to use the seven million dollar figure that had previously been approved by him. (R. 224; R. 1604; R. 1675-1677). Reprints of this article were distributed by West Coast to broker-dealer firms inquiring for information and the article was received by Pennaluna without Pennaluna's knowledge of the inaccuracy of the statement. (R. 225). The October 15, 1962 issue of Newsweek described an archery installation and its costs. (Scrapbook II, page 6).

Magnuson was in Seattle on October 3, 1962, and talked with Jack Gay; however, he did not ask for any financial information and testified that he would not have obtained it if he had asked for it. (R. 1254). Gay and he were not friendly at that time. (R. 1255). On October 9, 1962, he sent some tax suggestions to Dr. F. E. Scott; however, his suggestions were not accepted. (R. 218; R. 2739). Magnuson and Harrison attended the opening of the Portland range on November 19, 1962, as did many other brokers. (R. 910; R. 1273). Magnuson offered the assistance of Golconda Mining Corporation if West Coast should need addi-

tional equity capital; this offer was refused flatly by Gay. (R. 1273-1275) (Magnuson is an officer and director of Golconda Mining Corporation, an Idaho corporation (R. 2885)). No financial information was sought or obtained by Harrison. (R. 845). Brokers in Portland were very enthusiastic (R. 845). Magnuson had no knowledge of the financial condition of West Coast, Silver Buckle or the Burien and Denver Archery Lanes at this time; nor did he know about Silver Buckle's unconditional guarantee or its guarantee of the Burien lease. (R. 1275; R. 1331; R. 1862-1866). He saw a Silver Buckle financial statement sometime during the fall of 1962, but it contained no information concerning West Coast. (R. 1314-1316). Scott and Gay also testified that Magnuson did not request financial information during the fall of 1962. (R. 1324; R. 1627; R. 2093).

During the fall of 1962, West Coast was attempting to obtain long-range financing. (R. 1872-1877; R. 4155; R. 4196-4210). Until West Coast could sell its Lessor's interest in the leases, Gay knew there would be a shortage of interim capital. (R. 1625). Richard Snyder, a recreation consultant, made a favorable report to Midwest Oil Company as a result of his study of the Denver opening; Vickers Oil Company also made a survey. (R. 220). Agreements actually were prepared between West Coast and Midwest Oil Company and executed by West Coast; however, the agreement was rejected by Midwest during the latter part of November, 1962. (R. 220; R. 2751-2780). As late as April

1963, Dickinson still thought Midwest might participate. (R. 220). Gay's efforts to obtain financing were unsuccessful but Magnuson was not aware of his activities, or the negotiations with Midwest until after Midwest rejected the deal. (R. 220; R. 1290).

The Booth Leasing Company had suggested to Gay that his financing efforts might be more successful if he obtained a guarantor. (R. 1635). Recalling Magnuson's earlier interest on behalf of Golconda Gay contacted him concerning interim financing and a guarantee from Golconda. Magnuson was told that West Coast was getting short of cash (R. 1765) and he agreed to supply some interim financing. On December 11, 1962, Magnuson sent a check to West Coast for \$20,000 (R. 1409) and an additional \$20,000 was loaned by him to West Coast on December 17, 1962. (R. 240). These loans subsequently were repaid by the issuance of 20,000 shares of West Coast stock to Magnuson at \$2.00 per share during the Spring of 1963. (R. 240).

Magnuson attended the opening of the Downey installation on December 15, but he did not receive any financial information. (R. 1631). The Silver Buckle stockholders letter, dated December 7, 1962, was prepared without Magnuson's knowledge by Hull, Scott and Gay. (R. 2090-2096; R. 2139). Financial information for West Coast was not included. (R. 2092).

In early December, Scott also called Magnuson to inquire about Golconda's previous interest. (R. 1278). A

copy of each lease agreement was given to Magnuson to present to the Golconda board of directors, along with a long-term cash projection prepared by Ford & Wade, Certified Public Accountants, which projected a sizeable cash balance at the end of 1962 and larger cash balances at the end of 1963 and 1964. (R. 1279, 1280; see similar projection at R. 1446-1451). Golconda, subsequently, committed itself to guarantee West Coast's anticipated recourse obligations under the sale of these four leases up to a maximum of \$420,000 in exchange for options to purchase West Coast stock and, as further security, the pledge to Golconda of the approximately two million shares of Silver Buckle stock previously obtained by West Coast. (R. 254). The Silver Buckle shares were deposited by West Coast in escrow at the Idaho First National Bank on December 11, 1962. (R. 258; R. 2991-2993). Silver Buckle also pledged to Golconda its remaining portfolio of mining securities and may have given Golconda a first lien on all its mining property, including the Vindicator project. (R. 254).

A third loan of \$10,000 was made by Magnuson to West Coast on January 9, 1963, evidenced by a promissory note. (R. 273).

At Gay's request, a preliminary financial statement for Golconda, as of December 31, 1962, was forwarded to Gay on January 16, 1963. (R. 285). The leases were sold to Guthrie Investments, Inc., a Washington financing corporation, for \$770,000 cash on January 28.

1963, with recourse against West Coast and Silver Buckle for any defaults in rent payments. (R. 288; R. 3058-3064). Jack Gay and Richard Cary, the attorney and Secretary for West Coast, executed the agreement on behalf of West Coast. Gay said that this sale would cover West Coast's long term financial needs. (R. 1323). The Bank of California purchased the paper from Guthrie and Golconda pledged 20,000 shares of Lucky Friday stock to the Bank in furtherance of its guarantee. (R. 288). At this time Magnuson and the Golconda directors received summaries of the financial information on the four lessees. (R. 288). The financial information referred to a date prior to August 13, 1962. (R. 3186-3188).

Golconda loaned West Coast \$20,000 for additional interim financing on January 24, 1963. (R. 287). Ford & Wade prepared an exhibit of proposed installations and earnest money deposits; \$38,600 earnest money deposits were received prior to January 31, 1963, \$8,400 between January 31, 1963, and the preparation of the schedule, and \$4,860,000 worth of leasehold contracts were shown. (R. 1678). Seven installations of 24 lanes each were anticipated to open between July 15 and December 1, 1963. (R. 3033).

The West Coast directors knew that their attachment to Silver Buckle, a mining company, was detrimental to the financing efforts of West Coast. Consequently, various merger and spin-off proposals were being considered during the spring of 1963 for the purpose of isolating the mining properties of Silver Buckle. Magnuson was interested mainly in the mining properties of Silver Buckle and was not favorable to merger considerations. At various times his advice was sought as a professional accountant, but he was not involved in detailed discussions of the merger arrangements. (R. 1746, 1747). Magnuson was not being furnished financial information during March, April and May of 1963 and he was not involved in any detailed discussion of the finances of West Coast (R. 1757). Gay felt that the leases were delinquent, due to organizational problems, and he did not consider them in default. (R. 1747).

The West Coast 1962 Annual Report was issued February 28, 1963 with a financial statement for the period ending that date. (R. 298; R. 3287-3306). (Appendix, page 65). J. A. Hogle & Company (now Goodbody) became interested in underwriting an offering of West Coast stock (R. 301), and Gay informed M. Elwood A. Crandell, Hogle's underwriting manager, of the financing and merger plans of West Coast on March 26, 1963. (R. 3323-3325). Pacific Northwest Company had declined to act as underwriter on March 7, 1963. (R. 3320). Magnuson learned of the terms of the proposed merger on about March 27, 1963; he also discussed the financial problems of West Coast, the need for cash, and the "bogging down" of the prospective archery installations with Gay, Dickinson, Cary and Ford, the C.P.A. (R. 306). Magnuson's merger suggestions were not followed. (R. 306). On April 1, 1963, Magnuson requested to be advised of the approximate date of the opening of the next four or five installations. (R. 3339). On April 4, 1963, Gay, Scott and Magnuson met with Al Jama, a San Francisco real estate developer, who was involved in the Redwood City, California proposed lease; Jama agreed to put up \$100,000 cash, obtain a line of credit of \$300,000 for West Coast and become a director. (R. 309). Magnuson agreed to recommend that Golconda acquiesce in the merger if all the outstanding stock of Silver Buckle Mines, Inc. (a wholly-owned subsidiary to be formed to hold the mining properties), was pledged to Golconda to replace the approximately 2,000,000 shares of Silver Buckle which had been pledged in the Guthrie guarantee obligation. (R. 311).

The Merger of West Coast and Silver Buckle

Notice of the annual meeting of stockholders of both companies was sent about April 24, 1963, together with financial statements for both companies and the merger agreement. (R. 314; R. 3480-3523). Silver Buckle Mines, Inc. was incorporated on May 3, 1963 and all the assets of Silver Buckle Mining Co. were transferred to it in exchange for all its shares. (R. 322). The shareholders of West Coast approved the merger of Silver Buckle Mining Co. and West Coast on May 25, 1963. (R. 331). Glen Sherman a Kennewick businessman, had been recruited to become President after the firing of Dickinson and Magnuson reluctantly became a director only to fulfill his promise to Sherman. Magnuson, Scott, Gay, Jama, and Sherman

were the new directors. (R. 331). The new management felt that the removal of Dickinson as president would stop the excessive spending and it is further stipulated that the new directors thought the finance, sales and operations problems could be solved. (R. 333, 334). During February through April, 1963, the leases had shown that they could produce substantial operating revenues. (R. 333).

The merger took place on June 10, 1963; the stock of West Coast was split into 2½ shares of new, no-par stock and Silver Buckle shareholders received one share of the new stock of West Coast in exchange for 5 shares of Silver Buckle stock. (R. 331; R. 336). The old Silver Buckle stock was surrendered and cancelled. At a special meeting of the board on June 11, 1963, each director received a current operating statement for West Coast. (R. 338; R. 3555-3559). The balance sheet showed a cumulative deficit of \$334,657.32 and the profit and loss statement showed a loss of \$37,521.56 for the month of May; net profit for the first five months of 1963 was \$76,498.10. (R. 338).

About May 31, 1963, Silver Buckle loaned \$25,000.00 to West Coast and, about the same time, Scott and Magnuson jointly loaned West Coast \$20,000.00. (R. 335).

Trading Activity by Pennaluna and Harrison

Throughout this period of time, Pennaluna, through Harrison, was engaged in its normal trading activities. Pennaluna does not publish its quotations in any news

media and it does not place quotations in the so-called "sheets" operated by the National Quotation Bureau. Inc. (R. 210). Its bids and offers for Silver Buckle stock during 1962 and the first half of 1963 are shown on the schedule at pages 2438-2447 of the Record. These quotations sheets were correlated into a composite quotation sheet distributed to the news media and to the SEC for each trading day. (R. 210). Pennaluna generally was the highest bidder for Silver Buckle stock as well as other mining shares sold on the Spokane over-the-counter market. During the months following the New Park-East Utah transaction, Pennaluna's bids frequently were matched by J. A. Hogle & Company. For instance, on October 2, 1962, J. A. Hogle bid 11/3c higher than Pennaluna; it matched Pennaluna's bid on October 10 and exceeded the bid by 1c on October 15. (R. 2442). The respondent has summarized the schedule and states in its findings and conclusions that Pennaluna was the single high bidder on only 34 days out of 56 days upon which Pennaluna and one other firm submitted bids during this period. (R. 4614). The national stock summary for the period October 1, 1962 through April 1, 1963 lists 24 companies who were making a market in the stock of Silver Buckle during that period; Pennaluna is not one of the firms listed. (R. 2448).

From October 1, 1962 through January 8, 1963, the respondent finds that the bid quotation and the subsequent market price throughout the nation rose steadily from 22c to a high of \$1.40. (R. 4614). A schedule

showing transactions in the stock of Silver Buckle by the 32 broker-dealers most active in this stock for the period September 1, 1962 through December 4, 1962 is found at page 2938 through 2940; the Record also contains a schedule of all transactions in Silver Buckle stock by 92 broker-dealers during September and October, 1962. (R. 2941-2986).

The trading volume shown on these schedules for the period September 1, 1962 through December 4, 1962 was 2,512,462 shares; Pennaluna confirming as principal in all transactions bought 532,600 shares and sold 562,205 shares during this period; J. May & Co. (New York), R. E. Nelson & Company (Spokane, Washington), J. A. Hogle & Company (Spokane and national offices), Cromer Brokerage (Salt Lake City, Utah), Wallace Brokerage (Wallace, Idaho), and Ingalls & Snyder (New York, all had purshases or sales in excess of 100,000 shares. (R. 2938- 2940). 44 percent of Pennaluna's transactions between March 1962 and June 5, 1963, were with Harris Upham, Walston Company (Seattle and Pasco), Dean Witter & Company, Davidson (Great Falls, Montana), Merrill Lynch, Pierce, Fenner & Smith, and Bache & Company. (R. 883).

Pennaluna communicated with broker-dealers outside the City of Spokane by teletype. Of the hundreds of teletype conversations that took place during this period, the respondent contends that less than 10 such conversations with J. May & ('ompany (New York),

Walston and Company (Seattle) and E. E. Smith reflect the alleged manipulative scheme. Generally, these conversations discussed current market activity in Silver Buckle stock and reflected Harrison's opinion concerning future activity and price. In these conversations, Harrison did not disclose that Pennaluna had directly or indirectly acquired a block of Silver Buckle stock from New Park or East Utah. (R. 257).

It is stipulated that Harrison's predictions concerning the price of Silver Buckle and other mining securities were based upon his experience as a trader and his skill in the business predictions of the price of mining shares to the same extent that other broker-dealers customarily engaged in such predictions. (R. 214; R. 890). It is further stipulated that, in connection with such predictions, Harrison had received no non-public information at any time about West Coast or Silver Buckle from Magnuson, and that these predictions were made without the benefit of any current financial information concerning Silver Buckle or West Coast. (R. 215) (Appendix, page 9).

Indicative of the nation-wide interest in Silver Buckle are the research and predictions made by Walter Faubion, a registered representative of Walston & Company. On November 30, 1962, Faubion teletyped Walston's research office in New York that he did not see any reason why the stock of Silver Buckle should not go to around \$5.00. (R. 954, R. 956). A copy of this teletype was sent to Pennaluna by Faubion with

a request to buy 200 Silver Buckle shares for a customer. (R. 955). Harrison was also authorized to post the teletype on Pennaluna's bulletin board. (R. 955). Faubion continued his enthusiasm in a letter to Mr. D. J. Cullen, Vice President of Walston. (R. 3049). A copy was sent to Magnuson, together with a copy of Faubion's notes and price predictions. His final price prediction for Silver Buckle was \$25 by January 1, 1965. (R. 1484-1488). Faubion also assisted West Coast in its financing efforts. (R. 2996, 3000). Further evidence of the interest of other broker-dealers is shown by a brochure on Silver Buckle prepared by G. Everett Parks & Co. Parks recommended the purchase of Silver Buckle shares, although not referring to the company by name, and referred to his firm's detailed study of Silver Buckle. (R. 251; R. 2924).

West Coast's archery equipment was publicized as a part of a TV show presented by ALCOA on January 31, 1963; at least 500 persons and firms were notified by West Coast, including many broker-dealer firms and financing houses, and the show received wide-spread advance publicity. (Scrapbook II, page 12). There also was a report on January 7, 1963 in the National Observer, a Dow-Jones publication. (R. 277) (Scrapbook II, page 12). An article on West Coast appeared in the Wall Street Journal on March 21, 1963, referring to \$5 million worth of equipment used by archery lanes. This figure was furnished by West Coast (R. 312) and was based upon various letters and down payments received from interested persons during

the fall of 1962 and the first part of 1963. (R. 3349-3473). There was a second article on the Downey Archery Lanes in the Wall Street Journal on April 18, 1963. (R. 312; R. 3348).

West Coast's Activity After the Merger

About May 13, 1963, Midnite Mines, Inc., a substantial mining company, obtained shareholders approval for an exchange of stock with West Coast which would give West Coast about \$500,000 of additional borrowing strength; the stock exchange did not take place. (R. 333).

The Bank of California, as Guthrie's assignee, knew the status of the rental payments on the Portland, Downey and Covina installations which had become delinquent. (R. 324). Despite this knowledge, the Bank of California made three unsecured loans to West Coast of \$50,000 each on May 22, 1963, June 27, 1963, and July 17, 1963. (R. 324). On October 23, 1963, Guthrie Investments, Inc. purchased the lease for the Redwood City archery lanes. (Redwood City became operative in December, 1963. (R. 334)). Both Guthrie and the Bank of California felt that West Coast's problems were the result of normal growing pains, including the lack of operating capital on the part of the lessee and lack of a full season for operation. (R. 325).

Despite the difficulties with the archery ranges and large expenditures for promotion and overhead, West Coast still had a net profit for the first six months of 1963 of \$45,429.28. (R. 345; R. 3565-3569). Because of a loss in July, the first seven months of 1963 showed a net loss of \$4,689.12. (R. 355; R. 3590-3594).

From August 14, 1963 through December 31, 1963 Magnuson sold 29,351 shares of West Coast stock, both for his own account and his children's accounts for which he acted as custodian. (R. 430). These shares had been purchased during December 1962; the respondent's findings state that, of the 5,250 shares sold to Pennaluna during September, 1963, only 750 shares were resold. (R. 4612).

About September 1, 1963, Magnuson loaned West Coast \$20,000 and Golconda loaned it \$25,000. (R. 364). A further loan of \$5,000 was made by Magnuson on September 24, 1963, convertible to West Coast stock at the rate of 80c per share; (R. 371) Magnuson provided West Coast with an additional \$10,000 on October 12, 1963. (R. 379). In addition to this direct financing, Magnuson was assisting West Coast during the summer of 1963 by contacting publishers of financial reports, financing houses, and other broker-dealer firms.

In a letter to Sherman on September 26, 1963, Magnuson reaffirmed his confidence in the company and the progress made by Sherman; he stated that with an additional \$200,000 of financing, West Coast would have a bright and successful future; these expectations were based in part on the efforts of Jama to obtain a

line of credit for the company. (R. 3620). On October 12, 1963, Magnuson reported a conversation with Guthrie to Sherman; he stated that Guthrie would purchase the Jama lease (Redwood City) and that the Bank of California was not concerned about West Coast's finances. (R. 3628).

Mineral Exploration Company, an affiliate of the Vinnell Corporation, was interested in the Silver Buckle mining properties. (R. 404). Mel Redhead, a geologist employed by Mineral Materials, Inc., also was doing a field examination of the Vindicator and Silver Buckle properties for his company. (R. 391; R. 3628). A favorable geological report was submitted later that fall. (R. 404; R. 3647, R. 3648). On October 15, 1963, Sherman recommended that West Coast sell only on a cash basis, F.O.B. Seattle; he also advised a person inquiring about West Coast stock to contact Ray Moore, a representative of Bache & Company, a Seattle broker-dealer. (R. 380).

The Redwood City lease was sold to Guthrie on October 23, 1963 for \$164,000; West Coast's recourse obligations were guaranteed by Magnuson and Golconda up to a maximum of \$35,000 and \$25,000 respectively. (R. 384). A complete resume of West Coast's financial problems was given to Magnuson by Sherman on November 6, 1963. (R. 3643).

The Brunswick Corporation had been investigating West Coast's archery business during October, November and early December 1963; before Christmas of 1963, the directors of Brunswick decided against entering the archery business. Brunswick reported to Magnuson that it recognized the potential of archery but felt that it would take five years and approximately \$12,000,000 to develop the market. (R. 399). Golconda was required to make a payment of \$42,241.12 to Guthrie and California tax authorities; pursuant to its guarantee obligations; on January 8 and 9, 1964, Golconda, as pledgee, sold pledged assets of Silver Buckle Mines, Inc. for reimbursement of this amount. (R. 411).

Pennaluna loaned \$12,200 to West Coast for the purchase of certain claims of creditors in the fall of 1963. (R. 416).

On January 13, 1964 West Coast directors decided to discontinue the archery business, except for the completion of orders sold for cash to Kanematsu & Co., Ltd. a Japanese concern. (R. 412; R. 3228-3260). A public offering of the shares of Silver Buckle Mines, Inc. pursuant to the regulation A exemption from Section 5 of the Securities Act of 1933, was being considered at this time; Richard Cary met with Mr. James E. Newton, Regional Administrator of the respondent, concerning this offer on or about February 21, 1964. (R. 3698). Magnuson resigned as a director on February 21, 1964 on the advice of his attorney Alden Hull. (R. 3700).

Although Magnuson was no longer an officer or director of West Coast after April, 1964, Magnuson

loaned an additional \$80,000 to West Coast for the purchase of claims and the payment of administrative expenses, guaranteed an obligation of Silver Buckle to Guthrie to the extent of \$100,000 and agreed to indemnify the liquidating trustee of West Coast against certain contingent and disputed claims. (R. 417). These guarantees by Magnuson and other shareholders freed the stock of Silver Buckle Mines, Inc. from the pledge to Golconda for distribution to shareholders and creditors of West Coast. (R.417).

Since automated archery was not being accepted by the public, despite the substantial improvement by the lessees in the Spring of 1963, the directors of West Coast decided to place the company in a voluntary receivership. The notice, letter, and plan of liquidation are found at page 94 of the Appendix Over 80 percent of the outstanding stock was voted in favor of liquidation at the shareholders meeting on March 19, 1965. (R. 417). Approximately 5,000,000 shares of the outstanding stock of Silver Buckle Mines, Inc. were distributed to the shareholders of West Coast as a liquidating dividend and the shares of Silver Buckle Mines, Inc. now are actively traded. Magnuson and Pennaluna received 733,333 shares and 81,333 shares respectively. Magnuson paid \$100,000 to Guthrie and received 1,000,000 shares. Guthrie also received 1,662,500 shares of Silver Buckle in satisfaction of that corporation's debt to Guthrie Investments, Inc. (R. 418). Magnuson's total investment exceeds \$250,000. The final payment has been made to the liquidating trustee and all

liabilities of West Coast have been settled satisfactorily. (R. 4547).

At this time, Magnuson has no interest in Pennaluna either as an officer, director or stockholder, and is not engaged in the securities business in any manner.

III.

SPECIFICATION OF ERRORS AND QUESTIONS IN THE CASE

- A. Whether or not there is substantial evidence in the Record to support the respondent's finding that petitioners failed to establish that the shares of Silver Buckle purchased and sold were exempt from the registration requirements of Section 5 of the Securities Act of 1933.
- 1. Did the respondent place the burden of proof upon the proper party and did the respondent properly apply the standard and quantum of proof required?
- 2. Did the respondent consider only material evidence contained in the Record and properly evaluate and give weight to evidence supporting petitioner's contention?
- 3. Do the respondent's findings comply with its obligation to present specific, detailed factual conclusions particularly with reference to its finding of a viola-

tion of Section 5 of the Securities Act by each petitioner on a different basis?

- 4. Does the order denying reconsideration contradict the respondent's previous findings and opinion by stating that Oil, Inc. was not a member of a control group?
- B. Whether or not there is substantial evidence in the Record to support the respondent's finding that each petitioner violated Section 10(b) of the Securities Act and Rule 10(b)6 promulgated thereunder.

If the shares involved are exempt from registration and a special selling effort is not present, upon what basis can the respondent find that the necessary distribution was taking place?

- C. Whether or not there is substantial evidence in the Record to support the respondent's finding that each petitioner was engaged in a manipulative scheme in the sale of stock of Silver Buckle Mining Company and West Coast Engineering, Inc. contrary to the provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Securities Exchange Act and the rules promulgated thereunder.
- 1. Can less than ten TWX conversations made by Pennaluna over a substantial period of time sufficiently establish that a manipulative scheme was present in the absence of excessive bidding and trading in the stock of Silver Buckle?

- 2. Do the respondent's findings contradict the stipulation that it was Magnuson's policy not to give Harrison non-public information:
 - (a) By concluding that improper price predictions were made;
 - (b) By concluding that certain statements were misrepresentations materially affecting the market activity for Silver Buckle stock;

without finding that the above policy was not followed with regard to Silver Buckle stock?

- 3. Upon what basis does the respondent find that Harrison had a duty to discover and subsequently disclose financial information concerning West Coast Engineering, Inc. and further charge Harrison by implication with a responsibility for the activities of West Coast's management?
- 4. Does the respondent's finding that there was no tangible basis for belief in the financial solvency of West Coast during August, 1963 constitute an arbitrary and capricious disregard of legitimate efforts to obtain the necessary financial assistance?
- D. Whether or not the Division of Trading and Markets purposely led the petitioners into a belief that a sanction of suspension of a certain number of days would be forthcoming from the respondent, which representations and inducements caused petitioners to

present a stipulated record appropriate only for documentary evidence.

Did respondent's staff purposefully exclude exculpatory and mitigating material from the Record and further conduct the proceedings contrary to the intent and purpose of the Administrative Procedure Act?

- E. Whether or not the sanction imposed by respondent constitutes an arbitrary and capricious abuse of respondent's discretionary enforcement powers.
- 1. Did the respondent properly consider opinions and material supporting the character and integrity of petitioners and Pennaluna's valuable function in the Spokane Stock Exchange and the over-the-counter market?
- 2. Did the respondent properly evaluate remedial efforts undertaken by petitioner Pennaluna and present compliance by Pennaluna with the record keeping and accounting rules of the respondent and the Board of Governors of the Federal Reserve System?

By stipulation the petitioners have preserved their right to object to the relevancy or materiality of any evidence considered by the respondent. (R. 443). Because of the conclusory nature of respondent's finding and opinion, petitioners are unable to set forth in index form the exhibits presented, together with their admission or rejection. A simple index of the substantial number of exhibits in the Record would further en-

umber this brief, and would not aid this Court. Petioners will emphasize and continue their objection any immaterial or irrelevant evidence which may ave been considered by respondent.

IV. ARGUMENT

The findings, opinion and orders of the respondent re not supported by substantial evidence. In construing the substantial evidence concept, this Court must onsider evidence in the Record fairly detracting from and contradicting the evidence relied upon by repondent. The whole record must be considered. Uniersal Camera Corp. v. N.L.R.B., 340 U.S. 474, 488, 5 L.Ed. 456, 467 (1951). The consideration of all maerial evidence and exhibits is critically important in his case, as improper inferences have been drawn by espondent from irrelevant facts.

Purchases and sales of Silver Buckle stock by petitioners during 1962 and by Pennaluna during 1963 were exempt from the registration requirements of Section 5 of the Securities Act (15 U.S.C.A. 77e); Magnuson was not a controlling person or a member of group in control of Silver Buckle during 1962 and arly 1963 and Pennaluna did not purchase Silver Buckle shares from Magnuson in the Oil, Inc. and New Park transactions. The respondent has disreserded the basic elements of the control concept.

The alleged misrepresentations made to other brokerealers by Harrison in less than 10 TWX conversations cannot support an inference of a manipulative scheme, since this "broker's chatter" could not have had a substantial effect upon the rise in price of a stock caused by nation-wide publicity and brokerage activity. The financial success of a developing company can be determined only over a long period of time; it is improper for the respondent to emphasize current difficulties without giving weight to the possibility of long-term success, particularly when a manipulative scheme is alleged. The "whole record" indicates that there was no violation of the anti-fraud provisions of the Acts by any petitioner.

The Division of Trading and Markets purposefully induced petitioners to present the matter to the respondent on stipulated facts, a posture of the case appropriate only for a sanction of suspension or censure. Because of the nature of the administrative process, petitioners must be informed of the exact sanction sought by the staff. Revocation is discretionary, and petitioners otherwise are unable to appreciate the severity of the allegation. If petitioners had known that revocation rather than suspension was the goal of the staff, a hearing would have been requested, at which the demeanor of the witnesses could be considered and more detailed findings made by an examiner.

Petitioners further request this Court to determine that the sanction imposed upon petitioners is a clear and dangerous abuse of the respondent's discretionary enforcement powers. THE RESPONDENT'S FINDING THAT THE SILVER BUCKLE
SHARES PURCHASED AND SOLD DURING 1962 AND 1963
BY PETITIONERS REQUIRED REGISTRATION UNDER
SECTION 5 OF THE SECURITIES ACT (15 U.S.C.A. 77e)
IS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE

A. The respondent required petitioners to establish an exemption from registration; under the circumstances of this case, placing the burden of proof upon petitioners constitutes an abuse of administrative due process of law.

Sale of the Silver Buckle shares purchased by Magnuson and Pennaluna from Oil, Inc., in May, 1962 and New Park-East Utah on September 29, 1962 required registration under Section 5 of the Securities Act only if the selling party was a controlling person or a member of a control group. Section 2(11) of the Securities Act defines underwriter as including one who purchases from a controlling person; the presence of an underwriter in a transaction then places that transaction within the scope of the Section 5 registration requirement. The respondent clearly placed the burrequirement.

^{1.} Section 2(11) of the Securities Act (15 U.S.C.A. 77b(11) states as follows:

[&]quot;The term 'underwriter' means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term 'issuer' shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer or any person under direct or indirect common control with the issuer."

den upon petitioners to prove by a preponderance of the evidence that the controlling person and underwriter concepts were not present. Although petitioners feel they met this burden, to require them to do so still disregarded the constitutional protections of the administrative process.

We are concerned not with a simple fact issue but with a much more difficult problem of rebutting a presumption. Purchases from an issuing company carry a presumptive need for registration, and, since this need should be apparent, it is consistent with administrative due process to require a seller or purchaser to establish that an exemption is present. To place this presumption upon non-issuers is not equally consistent. Rebuttal of a presumption requires much more than the mere preponderance of the evidence. Since the Division is the proponent of the claimed need for registration, the Administrative Procedure Act states that the Division shall bear the burden of proof. 5 U.S.C.A. 556(d).

S.E.C. v. Ralston Purina Company, 346 U.S. 119, 126, 97 L.ed. 1494, 1499 (1953) stated that:

"Keeping in mind the broadly remedial purposes of federal securities legislation, the imposition of the burden of proof on an issuer who would plead the exemption seems to us fair and reasonable."

The Supreme Court was concerned with a primary distribution from the issuing company, not a secondary

distribution from allegedly controlling persons. Later cases like S.E.C. v. Culpepper, 270 F. 2d 241 (2nd Cir. 1959) and Gilligan, Will & Company v. S.E.C., 267 F. 2d 961 (2nd Cir. 1959) involved a sale by the issuing company through the conduit of controlling persons. Consequently, the cases are not binding upon this Court.

That administrative due process of law has been abused is illustrated by the three successive theories of control presented by the Division.

- (1) During the deposition of Dr. F. E. Scott, the investigating representatives of the Division contended that New Park and East Utah had sufficient stock, (being approximately 1,400,000 shares) to control Silver Buckle and that the subsequent purchases by Magnuson and Pennaluna from those companies consequently required registration. (R. 2016).
- (2) Recognizing that New Park and East Utah were in opposition to the management of Silver Buckle and therefore unable to assert a controlling influence, the Division in its brief then attempted to establish an involved business and social relationship between Magnuson, Harrison and directors of Silver Buckle. (R. 3764-3768; R. 3921-3928).
- (3) Faced with a comprehensive rebuttal of this allegation by petitioners in their brief, (R. 4007-

4020) the Division then asserted that Oil, Inc., itself, was a member of the so-called group in control of Silver Buckle for purposes of establishing a need for registration of shares acquired in the Oil, Inc., transaction and subsequently sold. (R. 4433).

This last allegation was successfully rebutted in petitioner's supplemental brief; (R. 4517) the respondent has found in its order dated July 6, 1967 that Oil, Inc. was not a member of a control group in May, 1962. (R. 4662; Appendix page 124). Respondent apparently has concluded that only Scott and Magnuson were controlling persons — a contention not raised by the Division and therefore not directly dealt with by petitioners. (R. 4612; Appendix page 112).

Even assuming that this is an adversary proceeding, this constant change of position by the respondent and its staff indicates the need for this Court to establish a new standard for the burden of proof and to effectively clarify the scope of S.E.C. v. Ralston Purina, supra. When sellers of stock are not the issuing company and have legal opinions and other evidence indicating that the sellers (whether it is Magnuson or the selling companies) do not have a control status with the issuer, the respondent's staff must bear the burden of proof, if it seeks to challenge a prima facie exemption from registration. The concept of burden of proof is a judicial standard which must be interpreted to fit the needs of a particular situation. This

question should be remanded to the respondent for further findings consistent with a proper allocation of the burden of proof, and recognition of the respondent's administrative obligations.

B. The "whole record" does not support the respondent's finding that Magnuson was a member of a control group during the entire period under review; the respondent further has failed to make responsible, specific findings.

I Loss, Securities Regulation, 2nd edition, page 557 states the accepted test for determining a control status under Section 2(11) of the Securities Act (15 U.S.C.A. 77(b)(11)) as follows:

"Is a particular person in a position to obtain the required signatures of the issuer and its officers and directors on a registration statement? No other criterion would do, since the controlling person himself is not an 'issuer' except for the purpose of Section 2(11)."

Despite substantial and conclusive evidence to the contrary, respondent, apparently, concludes that Magnuson had this power at all times from May, 1962 through July, 1963. The respondent states that

"It appears that throughout the period when Silver Buckle's stock was being distributed, as described above, Magnuson and Scott were in effective control of Silver Buckle and by various arrangements and with the assistance of Harrison and the younger Cranmer were able to arrange for the acquisition of large blocks of Silver Buckle stock by friendly hands or for its disposition to new owners who would not pose the threat to the market indicated by Steen." (R. 4612; Appendix page 112).

The "period" referred to included two separate transactions and it is incumbent upon the respondent to make a responsible finding and conclusion for each transaction. S.E.C. v. Chenery Corp., 318 U.S. 80, 94-87 L.Ed. 626, 636 (1943). There must be a finding concerning the selling party in each transaction and the facts bearing upon the presence or absence of a controlling status at the time of acquisition or sale. To simply rely upon appearances violates the respondent's obligation to set forth specific, responsible findings S.E.C. v. Chenery Corp., supra.

1. The Oil, Inc. Transaction.

The details of this transaction are set forth on page 13-16 of this brief, and a schedule of the purchaser is found on page 2 of the Appendix. Magnuson owner 542 shares of Silver Buckle stock and had no connection with Silver Buckle prior to May, 1962. The respondent admits that Oil, Inc., the seller, was not a member of a group in control of Silver Buckle and that Scott arranged the transaction using Magnuson's name and account only to implement an escrow agreement (R. 4610; Appendix page 110) Magnuson became in volved in the transaction solely because of his interest in silver and because of his reputation for investment in mining ventures; (R. 1138, 1139). All purchase were made without any financial information. (R 1145). Since Pennaluna had resold its 90,555 share in the normal course of trading by July 14, 1962, it participation in the transaction was completed long efore the second purchase occurred on September 29, 962. (R. 2395, 2396; R. 4610).

If respondent does not accept the substance of the ransaction, it is incumbent upon it to make a finding 5 that effect. Under the circumstances, the shares urchased and sold by both petitioners were exempt rom registration under the provisions of Section 4(1) f the Securities Act. (15 U.S.C.A. 77d(1)).²

. The New Park Transaction.

Magnuson had no contact with Scott and Silver Buckle during the summer of 1962, prior to the Ruby Silver Mines dispute. (See page 16, 17 of this brief) He held less than 2 percent of the issued and outstandng stock of Silver Buckle and was not an officer or irector of the company. In order to protect Pennaluna and a public offering of the shares of Ruby Silver Jines, Inc., Magnuson arranged the meeting that reulted in the two contracts between the companies and silver Buckle and between the companies and Magnuson as the record purchaser. The respondent's indings state that Scott and Pennaluna had agreed to ourchase 300,000 shares and 200,000 shares respectively prior to the transaction. (R. 4610; Appendix page 110). That the companies are the selling parties should be bvious; each purchaser made his payment in to the Magnuson escrow account and received a certificate representing his proportionate interest in shares for-

^{2.} Section 4(1) of the Securities Act of 1933 exempts transactions by any person other than an issuer, underwriter or dealer from the registration requirements of Section 5 of the Securities Act.

warded to the escrow agent by New Park and East Utah. (R. 2609). The use of the Magnuson account for escrow purposes by the Spokane National Bank, rather than opening a separate account, should be completely irrelevant. The respondent, however, still avoids this question by refusing to make a specific finding as to the selling party for shares acquired by Pennalua and other purchasers. The details of the transaction are set forth on page 18-20 of this brief; the schedule of purchasers is found on page 4 of the Appendix.

Whether the 365,000 shares purchased by Magnuson in this transaction required registration prior to sale must rest first upon facts in existence at that time. The subsequent guarantee and financial assistance to West Coast by Golconda and the loans by Magnuson during December, 1962, have no bearing upon Magnuson's status as a member of a control group on September 29, 1962. The Golconda guarantee of West Coast's obligation did not become binding until January 28, 1963, the date of West Coast's sale of its lessor's interest in Denver, Portland, Downey and Covina leases to Guthrie Investments, Inc. (R. 288; R. 3058-3064). Only Golconda's interests were being protected by Magnuson as is conclusively demonstrated by the limited guarantee and by the pledge of Silver Buckle shares and Silver Buckle securities portfolio as security. (See page 27 of this brief). The first loan by Magnuson was made on December 11, 1962 (R. 240). There is no evidence that he had any financial information or exercised any influence whatsoever upon Silver Buckle or West Coast

prior to late April, 1963. To say that "beginning in late, 1962, Magnuson became deeply involved in the affairs of West Coast" is a gross distortion of the facts, in addition to being completely irrelevant to his status on Septembr 29, 1962. (R. 4611; Appendix page 111). These inferences cannot possibly affect Pennaluna's purchase from New Park-East Utah.

The respondent further finds that Harrison and Pennaluna, although purchasing 100,000 shares for Pennaluna directly from New Park and East Utah (non-controlling persons), sold for or on behalf of a controlling person in violation of Section 5 of the Securities Act. (15 U.S.C.A. 77e) (R. 4612; Appendix page 112). Resale of these shares was completed on or about December 5, 1962. (R. 2411). For these shares to require registration the respondent must believe, although it did not specifically find, that Magnuson was a controlling person during October, November and December, the period of sale. Under the circumstances, Harrison did not know or have reason to know of any facts leading him to believe he might be an underwriter. Not even the respondent can find enough facts to make a specific finding.

On January 10, 1963, representatives of the Division of Trading and Markets told Magnuson that they were concerned about the possible status of New Park and East Utah as companies in control of Silver Buckle. (R. 278; R. 3014; R. 4613). Since that contention is no longer being raised and has been conclusively rebutted by the evidence in the record, the conversation

itself does not constitute any forewarning to petitioners of the subsequent action by the respondent. Legal opinions obtained by Silver Buckle and Magnuson from John Lee and Alden Hull, attorneys experienced in S.E.C. practice, have been fully substantiated by the respondent's findings. (See opinions on pages 5 and 7 of the Appendix). Therefore, Harrison and Pennaluna, in particular, were entitled to rely upon those legal opinions. This is not a breach of promise suit; petitioners were entitled to make their own determination concerning the need for registration of the shares they acquired and sold. Petitioners continue their objection to reliance upon this discussion for any probative purpose, since it is immaterial and irrelevant. (Objection Preserved, R. 443).

Certificates representing the second 100,000 shares purchased by Pennaluna had been placed in a special envelope and charged to the drawing account of Harrison and Magnuson on or about January 12, 1963, on a 62½-37½% basis, as a result of the discussion with the Division's representatives; this was only a good faith effort to cooperate with the respondent during its investigation of the rise in price of the stock of Silver Buckle. Having determined that the basis for the discussion was not accurate, and further relying in part upon the Silver Buckle letter to brokers on March 5, 1963 (See Appendix page 86), the 100,000 shares were sold to Pennaluna through the account of Jerry O'Brien. These shares then were sold by Pennaluna in the normal course of its trading activity from May 2,

1963 through July 17, 1963. (R. 2434-2437). Tax considerations and other factors motivating this transaction are discussed at page 21 of this brief. That petitioners did not contact the Division prior to the transaction has no probative value.

The shares attributable to Magnuson and sold by Pennaluna, as well as the 750 shares of West Coast purchased by Pennaluna, as well as the 750 shares of West Coast purchased by Pennaluna from Mary Magnuson (purchase price \$1,387.50), on August 26-29, 1963, would qualify for the exemption for "broker transactions" set forth in Section 4(4) of the Securities Act (15 U.S.C.A. 77d(4)),3 if Pennaluna had confirmed the transaction as agent rather than as principal. These shares were less than 1 percent of the outstanding stock of the issuers and the transactions would be within the definintion of "brokers transactions" set by Rule 154 (17 CFR 230.154) but for the fact that Rule 154 does not include principal transactions. (Other sales of Silver Buckle by Magnuson had been made through other broker-dealers, as it was Magnuson's policy not to trade through Pennaluna.)

We recognize that the respondent is not going to broaden the arbitrary limitations of its rule; however, we wish to point out to this Court that the presence

^{3.} Section 4(4) of the Securities Act of 1933 states that the provisions of Section 5 shall not apply to "brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders."

or absence of a technical violation of Section 5 of the Securities Act may turn on the manner in which the sale was confirmed rather than the substance of the transaction. As to the West Coast shares Magnuson further testified that he did not control his mother's account. Therefore, Pennaluna did not purchase the West Coast shares from a controlling person and the shares could be sold properly without registration.

C. Petitioners have established that a control group was not present as a matter of law; since the shares involved did not require registration, this Court should reverse and set aside the order.

"The concept of control herein involved is not a narrow one, depending upon a mathematical formula of 51 percent of the voting power, but is broadly defined to permit the provisions of the Act to become effective wherever the fact of control actually exists." H. R. Rep. No. 85, 73rd Cong., 1st Sess. 14 (1933).

The "fact of control" actually did exist in *In The Matter of S. T. Jackson, Inc. et al.*, 36 SEC 631 (1950). In that case, six stockholders, holding almost 75 percent of the common and preferred stock of the company, had organized the company and were active in its management. There was only a negligible market for the common stock prior to 1946 and the six stockholders obviously began disposing of their stock as part of a general plan. There were close business and social relationships among all six members of the group so that they were a cohesive group organizing and running the affairs of the company.

In Strathmore Securities, Inc. and Turner, Securities Exchange Act Release No. 8207 (1966) the 19 stockholders of a small corporation were united by family, personal, or business ties, and acted at the direction of a single person. A joint participation by stockholders in a scheme to purchase shares to distribute to the public was present also in S.E.C. v. North American Research Devel. Corp., 280 F. Supp. 106 (SDNY 1968); however, the court absolved three defendants who acquired their shares from a person no longer having a control status.

The factors uniting the groups in these cases are not found in this Record. Close business and social relationships did not exist between Magnuson and Scott. Until Magnuson became a director of West Coast, he had never been an officer, or 10 percent stockholder of West Coast or Silver Buckle. It is respectfully submitted that this Court should reverse and set aside the order on this issue, or, in the alternative, remand to the respondent for findings consistent with a proper allocation of the burden of proof.

SINCE A CONTROL RELATIONSHIP IS NOT SUPPORTED BY A CONSIDERATION OF THE WHOLE RECORD, A DISTRIBUTION WAS NOT PRESENT FOR PURPOSES OF RULE 10b-6.

Rule 10b-6 (17 CFR 240.10b-6) promulgated by the respondent to execute Section 10(b) of the Securities Exchange Act (15 U.S.C.A. 78j(b)) generally prohibits an issuer, underwriter or dealer, while par-

ticipating in a particular distribution, from bidding for or purchasing any security subject to distribution in the open market. The rule rests upon the presence of a distribution, a term not defined. The respondent admits that a special selling effort was not present (R. 4619; Appendix page 119) and the other customary criteria of a distribution were not present. (See, e.g. Bruns, Nordeman & Company, 40 SEC 652 (1961) and In the Matter of Theodore Landau, 40 SEC 1119 (1962). The respondent rests its finding of a violation solely upon its previous conclusion that Pennaluna was an underwriter in the Oil, Inc. and New Park- East Utah transactions and that Magnuson, by implication, sold shares during May, 1962 through June 1963 while a controlling person. (R. 4619; Appendix 119). Since the "whole record" does not support the threshold findings of control, substantial evidence does not support the finding of a violation of Rule 10b-6.

SUBSTANTIAL EVIDENCE DOES NOT SUPPORT A FINDING OF VIOLATIONS BY PETITIONERS OF THE ANTI-FRAUD PROVISIONS OF THE ACTS⁴

A. The respondent has failed to delineate the standard of proof applied by it as the trier of the fact.

The respondent does not state that the Division had the burden of proof. Assuming that this was recognized implicitly, the quantum of proof required by respondent is not stated. Misrepresentations are alleged which, if found, constitute fraudulent activity. A mere pre-

4. Section 17(a) of the Securities Act provides in part:

"It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —

"(1) to employ any device, scheme, or artifice to defraud," Section 10(b) of the Securities Exchange Act provides in part:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may describe as necessary or appropriate in the public interest or for the protection of investors."

Section 15(c)(1) of the Securities Exchange Act provides:

"(c) (1) No broker or dealer shall make use of the mails or of any means or instrumentality of interestate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this subsection, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent."

ponderance of the evidence is not sufficient for the judicial process; petitioners are entitled to the same degree of protection in the administrative process. The so-called stipulation of facts does not present stipulated ultimate facts; it only sets forth a succession of facts and events. (R. 86-445). Consequently, the respondent had the responsibility to sift and consider; the degree of proof it was using in this process therefore is extremely critical. Respondent should require a greater standard of proof akin to the "clear and convincing" concept for the proof of fraud in common law actions. That the elements of common law fraud are not required for securities misrepresentations does not negate the burden of proof concept. Because of the severity of sanction that has resulted in this action, using only a preponderance of the evidence standard constitutes deprivation of property without due process of law.

It is respectfully submitted that this Court should remand the action to the respondent for a further determination of the standard of proof to be applied to this issue.

B. Since even the preponderance of the evidence does not establish manipulative activity, the respondent's findings and opinion are arbitrary and capricious; the "whole record" does not support respondent's conclusion.

The respondent has not found that:

(1) Pennaluna and Harrison dominated the market for Silver Buckle and West Coast stock or controlled a disproportionate amount of stock;

- (2) Nor that an artificial market was maintained;
- (3) Nor that any purchases and sales were made at any price other than the prevailing market price, including sale of the shares acquired in the New Park-East Utah transaction on September 29, 1962;
- (4) Nor that any special selling efforts were adopted.

The respondent simply concludes that Pennaluna's normal trading activity, when coupled with alleged misrepresentations in less than ten TWX conversations and bullish price predictions, contributed substantially to the increase in trading and rise in price. (R. 4614; Appendix page 114). By inference only is such increase in trading considered harmful. The alleged misrepresentations and price predictions were not sufficient to establish the manipulative scheme by themselves; the respondent had to combine them with admittedly lawful conduct.

The question then must be:

How and upon what basis could the respondent conclude that it was the allegedly improper conduct rather than the proper trading activity that substantially contributed to the increase in price? It is respectfully submitted that the adminstrative process still must establish a relationship akin to the common law con-

cept of "proximate cause" and that the requisite cause and effect can not be found in the respondent's findings.

1. Trading Pattern and West Coast Publicity

Prior to September 29, 1962, there is no finding of a manipulative scheme. (R. 4613; Appendix 113). Consequently, the transaction during May, 1962, in which Pennaluna purchased 90,555 shares of Silver Buckle from Oil, Inc. for sale to the public is not involved. There are no allegedly improper TWX conversations at that time or allegedly unjustified price predictions; the flurry of market activity at that time, apparently, was proper.

The respondent emphasizes Pennaluna's lack of activity in this stock during September, 1962. If the respondent examined the conduct of other brokers during this month, it would find that the market was dull or "thin" due to the large blocks being dumped on the market by New Park and East Utah through the Cromer Brokerage Co. of Salt Lake City, (the so-called Salt Lake stock). J. May and Co., a New York broker with substantial trading activity, had sold 2,000 shares at 17c on September 4, 1962. (R. 4550). It is also stipulated that Magnuson first learned of the dispute that led to the transaction about the middle of September. (R. 197). Pennaluna's commitment to purchase 200,000 shares was made a day or two before the sale was negotiated. Pennaluna's bidding and trading activity during September prior to its purchase on September 29, 1962 is completely immaterial and could have no probative effect.

The opening of the Denver archery lanes during the week of September 29, 1962 obviously awakened the market. (R. 203; R. 2611). The extensive publicity campaign by West Coast began with the opening of the Burien archery range on September 1, 1961 and continued throughout the Fall of 1962 and the Spring of 1963. The Scrapbooks compiled by the company diagram the activity. (See pages 22-24 of this brief). See also the press kit and sales brochure with financial projections (Appendix, pages 15-64). Gay had always informed interested persons that an interest in West Coast could be obtained by a purchase of Silver Buckle stock. (See, e.g., Gay letter dated March 7, 1962 at R. 2315).

Respondent admits that this publicity stimulated investors demand for Silver Buckle stock. (R. 4614; Appendix page 114). Respondent does not contend that petitioners are responsible in any way for West Coast's operations or publicity. How was the respondent able to differentiate the effect of the publicity and widespread activity by other brokers from the allegedly improper activity of Pennaluna, Harrison and Magnuson?

On September 29, 1962, Pennaluna purchased 100,-000 shares of Silver Buckle stock from New Park and East Utah. (See page 18 of this brief). An effort to accumulate inventory for legitimate selling purposes at the lowest price obtainable is proper. In the Matter of F. S. Johns & Company, Securities Exchange Act Release No. 7972 (1966). Any alleged misrepresentation, therefore, must relate to the manner in which the shares subsequently were sold and their effect upon the market, not the means by which they were acquired.

From October 1 through December 4, 1962, Pennaluna did not have "by far" the greatest volume of trading, as the respondent concluded. (R. 4614; Appendix 114). Again, the volume of trading itself is immaterial and inferences can be drawn from the volume of trading consistent with lawful and unlawful theories. 92 brokers reported their transactions for September and October, 1962. (R. 2941-2986). Of 2,512,462 shares traded September 1, 1962 through December 4, 1962, Pennaluna bought 532,600 shares and sold 562,205; several other brokers also had a volume in excess of 100,000 shares. (R. 2938-2940). Hogle (Goodbody) reported a volume of 1,172,920 shares from September 1 - March 31, 1963. (R. 4314). Pennaluna is not listed as a market maker on the National Stock Summary for October 1, 1962 through April 1, 1963. (R. 2448; Appendix page 85). There was no so-called "handholding" between Pennaluna and any of these broker-dealers; no request was made to insert bids in quote sheets. During this entire period Pennaluna simply bought and sold in its customary manner.

The Securities and Exchange Commission believes that a typical feature of market manipulation is a rise in quotations without any demand for the stock. F. S. Johns, supra. This typical feature is not present. A comparison of the daily volume with the rise or fall in the Pennaluna bid on the following day shows a direct correlation between demand and price. Although Pennaluna always has been a high bidder, J. A. Hogle & Co. (now Goodbody) bid 1½c higher than Pennaluna on October 2, 1962, (R. 2442) the very next day after Pennaluna's improper-by-inference increase in its bid on October 1, 1962. (R. 4614). Hogle matched Pennaluna's bid on October 10 and again exceeded it by 1c on October 15. (R. 2442).

Consequently, Pennaluna's pattern of conduct during this period was quite normal and not designed to facilitate a manipulative scheme.

2. The TWX Conversations

The TWX conversations referred to in the respondent's finding at page 4615 of the Record have been set forth in full in the Appendix for the convenience of this Court. On October 4, 1962, Harrison had a TWX conversation with Anthony Vaghi, the trader for J. May & Co., (a market maker in Silver Buckle stock) (Appendix page 101). Harrison stated, among other things, that an agreement had been reached with New Park and East Utah. His prediction that Silver Buckle would be 65 "one of these days," by stipulation, was based upon his experience as a trader, and information that he had picked up "on the street" about Silver Buckle and West Coast. (See stipulation at

page 9 of the Appendix). Harrison had not received any non-public information or current financial statements. (R. 214, 215). Harrison also testified that George Hiltmyer, a representative of Harris, Upham and Company in Spokane, told him how good West Coast was going to be. (R. 217). An article about the transactions appeared in the Wallace Miner on October 11, 1962. (R. 222; R. 2823).

Throughout this proceeding petitioners have felt that respondent and its staff did not understand the manner in which mining securities are traded in the Spokane over-the-counter market and the factors that affect investment judgment. The TWX conversation on October 10, 1962 between Harrison and Walston & Co.'s Seattle office illustrates this point. (Appendix page 102). Harrison's statement that he "secs some very good inside buying on (Silver Buckle)" is one of the misrepresentations found by the respondent. (R. 4615; Appendix page 115). The Special Study of the Securities Market, Part 2, Chapter VII, states that the "inside" price is the price used by wholesale traders. The above TWX conversation refers simply to activity by "inside" buyers or wholesalers. (See also Vaghi testimony at R. 4490 in which Vaghi used the term). A trade term can not be the basis for any wild inference of a scheme or deal between Harrison and Walston. Selection of this conversation shows a gross lack of "administrative expertise" by respondent.

On October 26, 1962, Harrison stated to Vaghi again that Silver Buckle was headed for \$1.00. (R. 238; Ap-

pendix page 103). This statement was not based on any financial information or non-public information but was based upon reports from Seattle brokers and the general trend of the market. Harrison frequently talked with the Portland office of Walston. The Special Study, Part 2, Chapter VII, page 557, points out that trading decisions often depend upon intuition and a feeling for the market.

On November 10, 1962, Harrison told E. E. Smith & Co., that Silver Buckle was going to sell much higher. (Appendix page 104). The TWX conversations on October 19 and December 10, 1962, with Vaghi referred to the previous blocks of Silver Buckle being sold by Cromer Brokerage which the New Park-East Utah transaction took off the market. (Appendix page 103, 104). The candor with which Harrison stated that he was making a low quote to accomodate Salt Lake certainly belies any manipulative scheme.

On February 8, 1963, Vaghi asked if West Coast was showing a monthly profit. (R. 295; Appendix page 105). Harrison did not know or have access to financial information not available to other brokers. If, in fact, he had seen a financial statement for West Coast for the eleven months ended January 31, 1963, he would have seen net earnings for that period of \$43,711.18 and a reduced deficit for the company. (R. 3261).

During this period Harrison was not a controlling person or an insider; nor was he the partner of a person having that status. As shown above, Magnuson's contacts with the management of Silver Buckle and West Coast were peripheral until late April, 1963. Each statement responded directly to the question within the limits of the communication and the disclosure obligation of Harrison. For instance, Harrison accurately reported that a large block of stock was no longer available to depress the market; it was not incumbent upon Harrison to go further and reveal that Pennaluna had purchased a small percentage. Pennaluna's shares were absorbed in and out of his trading account without any depressing effect upon the market and the remaining shares were tied up by the escrow agreement for the next few months. Within standards known and understood by wholesale traders, Harrison complied strictly with his obligations.

Vaghi stated this standard in part when he testified that he relied only upon buy and sell orders to make his market. (R. 4487, R. 4499). He did not seek financial information and looked to Harrison as a source of broker's information, (similar to the type Harrison received from Hiltmyer) not special, inside information. Vaghi did not know or care about Magnuson's alleged relation with Harrison and West Coast.

A mining security like Silver Buckle does not trade on the basis of financial information; despite its union with West Coast, Silver Buckle still traded like a mining security. Options to buy Silver Buckle stock were given to G. Everett Parks (a New York broker) by Magnuson during October and November, 1962; (R. 235) it is quite significant that Parks did not request any financial information before making his commitment. (R. 1260). Petitioners submit that this is another factor which the respondent refuses to understand or believe.

Harrison did not have the financial information referred to by the respondent in its finding on page 4616. (Appendix page 116).⁵ To imply that he had this information violates both the facts in the Record and the overall stipulation that Magnuson (assuming he had such information) did not provide Harrison with any non-public information. (Appendix page 9-14).

The Division continually disregarded this stipuluation but petitioners felt that the respondent would not be influenced by obviously improper argument. Before the Commission, Mr. Lane Emory, the representative of the Division, stated:

"Thus, Harrison, through Magnuson, had a direct and constantly available source for the most

^{5.} Respondent's finding states in part:

As to the latter, West Coast had in fact sustained a net loss of \$203,063 for the nine months ended September 30, 1962, and had a cumulative deficit of \$276,835 as of that date which had increased to \$413,567 by the end of the year. In January 1963 West Coast sold for \$770,000 its equipment leases for the four archery ranges opened in late 1962, which created a contingent liability by West Coast and Silver Buckle of about \$851,000 for any rent defaults. At the time of that sale, one of the lessees was already in default on its rental payments. For the year ended February 28, 1963, during which it had sold the leases with respect to all five ranges then in existence, West Coast sustained a net loss of \$59,376 and as of that date had a deficit of \$167.477.

current public and non-public information about all of the business affairs of Silver Buckle and West Coast at all times between May 1962 and April 30, 1964." (R. 4574).

The respondent also has disregarded the stipulation as its findings charge Harrison with a responsibility for West Coast's management decision and the operations of the lessees. Harrison did not know or have access to this information.

Price predictions made by Harrison and price predictions made by persons in other cases are not comparable. In Alexander Reid & Co., Inc. 40 SEC 986 (1962) the registrant's salesman predicted that the shares of Woodland Electronic Company, Inc. could double in a short period, triple in 90 days, go up three or four times, and climb to \$15.00 or \$20.00 within the year. Another salesman felt that it would rise like other low stocks that had reached a price of \$40.00 and \$50.00 a share. The representations made to members of the investing public in Advanced Research Associates, Inc., Securities Act Release No. 4630 and Securities Exchange Act Release No. 7117 (1963) also referred to specific price figures and anticipated rises within a short period of time. These predictions were also made in a brochure distributed by the brokerdealer in conjunction with patently false statements of fact.

In Underhill Securities Corporation, Securities Exchange Act Release No. 7668 (1965) representations in the following form were held to be fraudulent:

"That AMD 'should double in three months,' could 'double or triple (the customers's) money in a year or two,' and that AMD has prospects of 'becoming something like an IBM or a Polaroid.'" "Could 'practically guarantee' that the price of AMD stock would triple in four months...."

Why isn't respondent concerned about the price predictions made by Walter Faubion, a registered representative of Walston & Co.? His prediction that Silver Buckle would hit \$5.00 and go beyond that figure in another year assumed that West Coast's archery would be successful, and was much more flamboyant than Harrison's. (R. 954).

It is obvious that Harrison's trading activity was proper and that his casual statements to other broker-dealers were not part of a selling effort. They were made solely to other traders and were understood by the brokerage fraternity; to say that these remarks "contributed substantially" to the increase in trading and rise in price demonstrates that the respondent has been infected by the Division's refusal to understand the wholesale market.

3. Magnuson's sales of West Coast Stock during August-December, 1963.

Respondent refuses to believe that there was any tangible basis for optimism concerning the eventual financial success of West Coast during the first half of 1963. That this finding completely disregards substantial evidence in the Record is shown by the facts recited on pages 28 through 31 of this brief. There were

several significant efforts to obtain financial assistance during the last half of 1963 and, if any of the companies interested in West Coast at that time had honored moral commitments, West Coast easily would have achieved financial solvency. The respondent does not refer to the study made by the Brunswick Corporation. Since it ignores this very important undertaking, petitioners have placed additional material in the Appendix. (Appendix page 125-131). A letter from Glen Sherman, the president of West Coast (a person of whom the respondent is not critical) written to Magnuson on February 12, 1964 stated that the company was in better shape than when he first assumed the presidency in June. (Appendix page 88-93).

The shares of West Coast, following the merger in June, still sold like a mining security and financial information was not necessarily required to make an investment decision. Since the financial condition of the company was complex and prospects for additional financing quite good during this period, Magnuson did not have a duty under Rule 10b-5 to disclose any adverse financial information to purchasers of West Coast stock sold at this time, still assuming that he had this financial information. Although the sale of these shares constituted a technical violation of Section 5 of the Securities Act, it is respectfully submitted that the respondent has not established that Magnuson violated the anti-fraud provisions of the Act.

Harrison's confidence in West Coast's future is supported by the excess of purchases over sales of the stock of West Coast by Pennaluna from June 11, 1963 to April 30, 1964. (R. 3717-3732). Common sense would indicate that Magnuson would not permit a corporation in which he owned $37\frac{1}{2}$ percent of the stock to actively trade in the stock of another corporation which Magnuson knew to be in a failing financial condition. The duty of disclosure requires an evaluation of all information available at that time. The respondent's finding fails to recognize significant and favorable evidence.

The respondent's findings and reasoning lack clarity necessary to enable this Court to make a considered judgment without substituting its own findings. *Kahn v. S.E.C.*, 297 F.2d 112 (2nd Cir. 1961). It is respectfully submitted that this Court should reverse and set aside that portion of respondent's order relating to these issues.

THE DIVISION OF TRADING AND MARKETS CONDUCT OF THESE PROCEEDINGS WAS CONTRARY TO ADMINISTRATIVE DUE PROCESS OF LAW

These proceedings were commenced by an order for private proceedings on October 1, 1964. (R. 65-71). The Division felt that these proceedings were conducted privately because of an agreement by petitioners that a stipulated record would be prepared. Thomas W. Rae, Assistant Director of the Division at that time, further stated in a letter to petitioners' counsel on February 22, 1965 that "it was further anticipated that if a stipulation were agreed upon, the

respondents would submit an offer of settlement." A stipulation including only events occurring from May, 1963 forward was prepared and an offer of settlement discussed. Since settlement could not be accomplished, the full stipulation was completed. The stipulation only stated the manner in which various events transpired; it was not a stipulation of ultimate facts. Settlement discussions were held frequently and offers of settlement were extended to the Division, both formally and informally; on July 18, 1966, an offer to settle for a suspension of a period not to exceed 30 days was presented to Mr. Rae. Since he would not consent, the offer was not submitted to respondent. Mr. Rae, and representatives of the Division in the Seattle Regional Office, refused to state what suspension terms and days were acceptable to them and inferred to petitioners that all parties desired the respondent to set the number of days and suspension terms.

Petitioners waived a hearing examiner and proceeded directly to oral argument, without being advised that revocation and bar was being sought. Even assuming these proceedings are remedial, not penal, petitioners are entitled to know the severity of the allegations and the sanction to be expected if *conviction* should result.

On February 2, 1966, after the opening briefs of both parties were submitted, the Division deposed Anthony Vaghi under oath without notice to petitioners' counsel

or opportunity to appear. Mr. Vaghi appeared without counsel. Statements made at that deposition were highly prejudicial to petitioners. Vaghi testified that Harrison was his only source of information and that he did not do any research. (R. 4488). In fact, Gay had sent Vaghi brochures and information about the archery lanes. (R. 1592). Denial of the right to cross examine or rehabilitate a witness is a serious and unwarranted abuse of governmental power.

Petitioners further believe that representatives of the Division corresponded with the respondent concerning Harrison's performance while president of the Spokane Stock Exchange and that damaging comments were made in memorandums directed to the respondent, or made available to the respondent, without knowledge of the petitioners or opportunity to counter the comments. Lane Emory also argued facts beyond the scope of the stipulation and further breached his obligations as a representative of a government agency. Such activity violates the Administrative Procedure Act. (5 U.S.C.A. 554(d)). All of these matters were brought to the attention of respondent prior to filing this petition for review. The petition and motion for further rehearing was refused by respondent. (Supp. R. 4690-4699).

Petitioners are entitled to fair play by government agencies. The Division conduct violated basic concepts of administrative due process of law.

CONCLUSION

Petitioners obtained statements from persons active in the securities industry in the State of Washington for the purpose of establishing the character and reputation of Harrison and Magnuson. (Supp. R. 4671-4689). Although these statements were considered ex parte' communications by respondent, they should have been considered by respondent since character and reputation of the individuals involved is a fundamental factor in making a "public interest" determination. Respondent has not accepted these statements and has not properly evaluated the efforts made by Magnuson to obtain payment for West Coast's creditors and save the mining properties for the shareholders of Silver Buckle Mines, Inc. Magnuson has severed all relationship with Pennaluna and does not intend to engage in the securities business in the future. Pennaluna's books and records now conform to all requirements of the respondent; an examination made on March 24, 1966 revealed only minor and customary reporting problems.

The technical violations occurring during late 1963 and the record-keeping violations found by the respondent cannot support a grave sanction of revocation and bar. The "whole record" does not support respondent's finding of violations of the anti-fraud provisions of the Acts and Section 5 of the Securities Act prior to May, 1963. The order issued by the respondent must be reversed and set aside and this case re-

manded to the respondent for a further determination consistent with the record and respondent's administrative obligations.

PAINE, LOWE, COFFIN, HERMAN & O'KELLY

Horton Hormon

Lawrence R. Small
Attorneys for Petitioner Harrison

Saxon, Maguire & Tucker by William J. Kenney

LeSourd and Patten
By Woolvin L. Patten
Attorneys for Petitioner Magnuson

Lowenstein, Pitcher, Hotchkiss & Parr By James C. Sargent Attorneys for Petitioner Pennaluna & Company, Inc. I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Lawrence 12 Small

United States Court of Appeals

For the Ninth Circuit

PENNALUNA & COMPANY, INC. BENJAMIN A. HARRISON, and HARRY F. MAGNUSON,

Petitioners.

v.

SECURITIES EXCHANGE COMISSION,

Respondent.

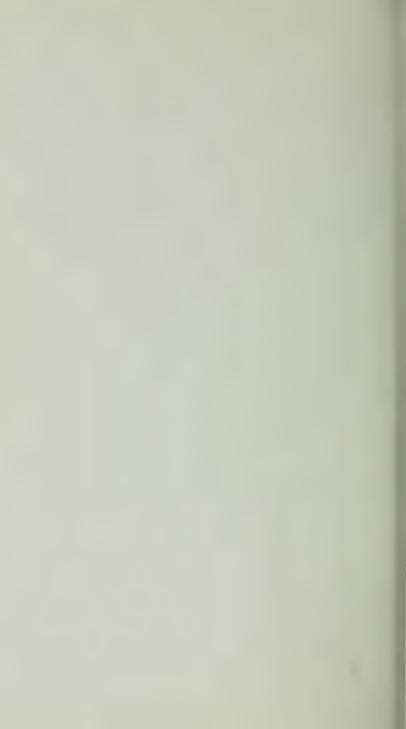
PETITION FOR REVIEW OF ORDER OF SECURITIES EXCHANGE COMMISSION

APPENDIX TO BRIEF OF PETITIONERS PENNALUNA & COMPANY, INC. BENJAMIN A. HARRISON, and HARRY F. MAGNUSON

Paine, Lowe, Coffin, Herman & O'Kelly 602 Spokane and Eastern Building Spokane, Washington 99201

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Attorneys for Petitioners



United States Court of Appeals

For the Ninth Circuit

PENNALUNA & COMPANY, INC. BENJAMIN A. HARRISON, and HARRY F. MAGNUSON,

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Attorneys for Petitioners

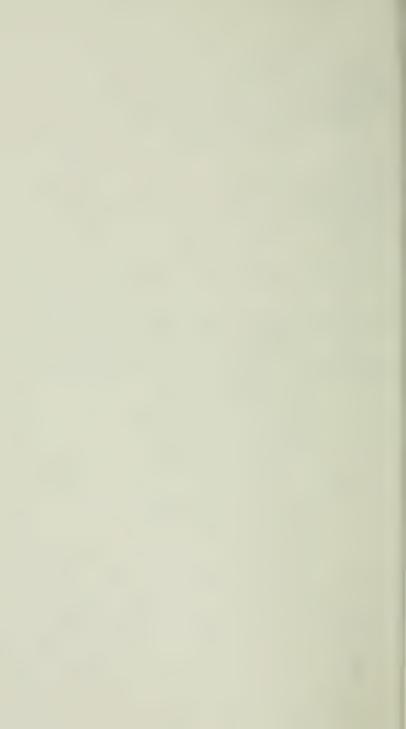


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APPENDIX

The exhibits set forth in the Appendix are taken from the Record in this matter and are set forth in this form for the convenience of this Court. The citation to the Record is found in the upper right hand corner of the page.

This schedule sets forth the purchasers of 600,555 shares of Silver Buckle stock sold by Oil, Inc. during May 1962. The schedule is taken from information contained on pages 178-180 of the Record:

Sales Arranged by Magnuson

Purchaser	Certificate in N/O	Shares
Elaine E. Drews Wallace, Idaho	(Purchaser)	3,000
Henry B. Deaton Wallace, Idaho	(Purchaser)	5,000
Arthur Rieske Wallace, Idaho	(Purchaser)	3,000
Joanne M. Lepo Wallace, Idaho	(Purchaser)	2,000
Ramona Boger Wallace, Idaho	(Purchaser)	5,000
Mary Magnuson Wallace, Idaho	Pennaluna	20,000
McGee Building, Inc. Wallace, Idaho	Pennaluna	10,000
Wray Featherstone Wallace, Idaho	Pennaluna	20,000
Donald Hess Wallace, Idaho	Pennaluna	10,000
Golconda Wallace, Idaho	Pennaluna	70,000
Leo Kraemer Wallace, Idaho	Pennaluna	5,000
Gus Voltolini Wallace, Idaho	Pennaluna	15,000

(Schedule Continued)

Sales Arranged by Scott

Purchaser	Certificate in N/O	Shares
William T. Butt Dayton, Ohio	(Purchaser)	25,000
Lucy B. Grimes Dayton, Ohio	(Purchaser)	25,000
Richard D. Sanders Pittsburg, Calif.	(Purchaser)	39,000
Harold A. Peebles Spokane, Washington	(Purchaser)	15,000
Leona Miles Superior, Montana	(Purchaser)	4,500
Charles Raccaro Wallace, Idaho	Pennaluna	7,500
Peter M. Dinehart Spokane, Washington	Pennaluna	5,000
Jack E. Scott Wallace, Idaho	Pennaluna	25,000
Piatt Hull Wallace, Idaho	Pennaluna	10,000
Dr F. E. Scott Wallace, Idaho		14,000
Harry F. Magnuson and Custodial Accounts Wallace, Idaho		172,000
Pennaluna & Company, Spokane, Washington	90,555	
, ,		600,555

This schedule sets forth the purchasers of 1,167,111 shares of Silver Buckle stock sold by New Park and East Utah pursuant to contracts executed September 29, 1962. The schedule is taken from information contained on pages 199 through 201 and pages 2591 through 2606:

Purchaser	Shares
Silver Buckle Mining Co., Wallace, Idaho	367,111
Pennaluna & Company, Inc.,	200,000
Spokane, Washington	
Harry F. Magnuson, Wallace, Idaho	365,000
Mary Magnuson, Wallace, Idaho	5,000
Alden Hull, Wallace, Idaho	10,000
Jack E. Scott, Wallace, Idaho	11,000
Robert E. Murray, Wallace, Idaho	2,000
Janet Miles, Superior, Montana	5,000
Pat Miles, Superior, Montana	1,000
Harry Stewart, Mullan, Idaho	1,100
Sanford Guttu, Seattle, Washington	1,000
Robert Brown, Spokane, Washington	57,000
Victor Fall, Helena Montana	40,000
Ray T. Miles, Superior, Montana	1,000
Leona Miles, Superior, Montana	1,000
Pia Raccaro, Wallace, Idaho	5,000
Charles Raccaro, Wallace, Idaho	1,000
Margaret E. Scott, Helena, Montana	1,000
Quinton Sampont, Silverton, Idaho	2,000
Howard Hollingsworth, Spokane, Wash.	25,000
Ethel Batzel, Spokane, Washington	25,000
Helen Irelan, Helena, Montana	5,000
Harry Voltolini, Wallace, Idaho	10,000
Jack Gay & F. E. Scott, Wallace, Idaho	25,900

1,167,111

I'. J. L. JE. OF BONS ATTORISEYS AT LAW WALTACK EDANG

Octaber J. 1952

Mr. H. F. Alignason bean Ballaing W. Hace, Idaho

MATE IN

Dear Mr. Angausons

On Newtoniber 29, 1962, you purchased 300,000 shares of the capital stock of Silver Euclis Mining Company from New Park Mining Company and Essi Utan Mining Company.

You have asked our opinion whether there are provisions in the Securities Act of 1955 or the Securities & Exchange Act of 1934 which place limitations upon your right to trade in these shares.

We understand the facts in rejacd to these shares to be as follows:

New Park and East Utah acquired these shares in 1954 as part of the program to findace the winking of the Vindicator shaft and held them until the sale of September 29, 1962.

Neither New Park nor East Utah were in control of or controlled by Silver Buckle. On the contrary these companies have assumed a position actively hostile to the management of Silver buckle. In one regard please refer to the attached letter dated August 24, 1962, from John F. Lee of the firm of Fabian & Gendenin.

Silver Buckle presently has 9, 400,000 shares issued and outstanding.

We uncorretand that in addition to the 300,000 shares, you own 115,000 and your entider, even 60,000 additional shares and Pennatura & Company, of which you are a protein own 200,000 additional shares. This is a total of 655,000 shares which you over or have an interest in.

You are not an officer or director of Solver Buckle, nor do you own directly or indirectly 10% of the outstanding phares,

it is our opinion that under the circumstances outlined above you are not a

Mr. H. F. Magnuson October 5, 1962 Pagn 2

verson im direct or indirect control of Silver Buckle, and there are no restriction. upon your right to trade in the 200,000 shares referred to above.

Yery truly yours,

H. J. Hull & Sone

PH:sa

CONTROL CONTRO

FABIAN E CLENDENIN

BALT LAKE CITY I, UTAH

August 24, 1962

Alden Hull, Esq. J. H. Hull and Sons Attorneys at Law P. O. Box 709 Wallace, Idaho

Re: Transfer of Silver Buckle Mining Company Stock

Duar Mr. Hull:

This letter will confirm our telephone conversation of this day.

As you and I both know, the Silver Buckle stock forwarded to you for transfer by Gromer Brokerage Company regisetured in the name of New Park Mining Company does not come from control sources. In fact, New Park Mining Company exercises, no control over the affairs of Bilver Buckle Mining Jompany, it has been unable to gain access to the books and records thereof evan though it is a stockholder and the law permits it that right. The strained relationship which exists between other Buckle's management and New Park demonstrates the antithesis of a control relationship. That fact is further demonstrated by the recent circumstances that have forced hew Park Mining Company if file a legal action against filver Buckle in order to obtain certain information from the company records which otherwise would be freely evaluable to a controlling person. The securities in question were by your own addission issued almost ten years ago. They were taken for investment and that investment representation has been amply demonstrated. I would think it would be clear at this point that the exemption from the registration requirements of the Securities Act of 1933 as provided by the first clause of Section 4(1) thereof is available for this transaction.

Aldan Mill, Esq.

Page Two

August 24, 1962

We trust you will proceed to transfer those securities forwarded to you promptly and that you will cause now Park and Mr. Crossr no further delay in doing so.

Vory truly yours,

J?L:md

cc: Mr. Jack Scott David H. Clegg, Esq. Mr. L. L. Cromer

The following paragraphs refer to the stipulation that it was Magnuson's policy not to give any non-public information to Harrison or Pennaluna and have been collected in this Appendix for the convenience of this Court:

During the time covered by these Findings, it was Nagnuson's policy not to give any information to Harrison or Pennaluna which concerned Silver Buckle or any of the companies, including West Coast Engineering, with which Magnuson, but not Harrison, was associated as an officer or director, unless such information was available through public sources. (R. 151)

In connection with this prediction, the TWX conversation on October 4, 1962 Harrison had received no non-public information about West Coast or Silver Buckle from any person, including Magnuson, and it was made without the benefit of any current financial information concerning these companies. It was Magnuson's policy not to give any information to Harrison or Pennaluna which concerned other companies with which he was associated as an an officer or accountant, unless such information was readily available through public sources. (R. 215)

DY HR. YOUNG:

1244

- Q Were you Marrison's source of information on Silver Buckle?
 - A Absolutely not.
 - Q You didn't tell your own partner?
- A I have a complete separate entity with respect to Pennaluna, I don't pass on information on anything that I receive. I am a certified public accountant and an orcher of several companies, and I don't tell Mr. Harrison anything about those companies. He has gotten and and we have threshed this out a couple of times, time and time again, but I always maintain a policy of not trading information lask

and forth.

1245

Q I take it then that you didn't explain soything to Mr. Marrison about West Coast and their archesy at the time you committed Foundamen for 200,000 charact

A All I told him was the information that I could get walking along the atreet. I didn't know anything about it myself. I didn't even know what archery constaved of.

Q Let me take you this; between the time you both obtained some Oil Inc. clock, or some stock from Oil, Inc., and the time you purchased this stock from Past Ciah and the other firms, had you made any considered the displacen of the mining properties of dilver Buckler you make you told us you had a pretty good idea because it were no the hill and you could see it. Have you also any further investigation?

A I made no further investigation of the change properties; I kept nypelf fully atuned to the decelement in the area, and thereafter on the HECLA and facing belong area, about that time, we started a project main. I define two properties that majorn the Vindicator. We reached a project that could have been about that time. Containly there was a very definite development in the land and attraction attraction which are the real of the project contains the start and many the allower circumstances are really were doved a project which are all through the land and area project to the large terms.

'62 and started upward, and that trend has continued up until the present time. We now have the highest Silver prices in some thirty or forty years. It has equaled the monetary price of our silver and our currency and as a consequence, we all know the silver dollar, that there is a definite shortage, and a subsiding of coins and as a result the silver shortage and one of these days we are not going to have any more coins. I would predict in the next six to nine months we are going to see an abrupt rise in price beyond the present price. This will affect the silver business. Now, at the same time, the lead prices have been continuing up, and they have gone/five and a half cents up to thirteen cents, and zinc prices have gone from nine and a quarter cents up to thirteen and a half cents and this is directly affecting the economy of all the Cocur d'Alene Mining District, and the whole Inland Empire.

Q Yes. Now, you told us in May, just when you purchased \$10,000 or \$15,000 worth of stock at a dime a chare you were doing it off the top of your head, and you kept the general price posture of the silver business in your mind and that you were doing this as a speculation?

- A Right.
- Q You made no deep research into this at all?
- A Right.
- Q A few months later you were willing to invest

\$200,000 of contingent liabilities, \$60,000 worth at 20 cents a share. Are you telling us that your increased optimism for the fortunes of this company was based solely on the silver and mining basis with no regard for the possible developments in archery?

A It was based largely on the silver and mining possibilities of the company, but it was with the understanding and knowledge that this archery aspect or project of the company apparently was coming along satisfactorily and that the company provided a possible new business. I folt, in other words, under the present circumstances with regard to my investment in Silver Buckle, because basically they had the mining properties the stock was worth tea cents and twenty cents, and you had a certainty of that. It wasn't going much lower, and conceivably it was the archery thing developing — with the archery thing developing it would go higher, it could go as high — but I don't know too much about archery. I just didn't check into it right away at that time.

Q In other words, are you telling us now that your feeling was that the development between May and September in the financing in the silver fields was so much higher that it warranted your investing five times as much at third the pulse, in effect?

A At that poles, and the fact that the archery opening

was in May -- I know nothing about it in September. These was an opening up of a new installation in Danves.

Q So this was a factor in your thinking at the time you purchased it?

A It was not the total factor, the major factor was the mining properties.

BY MR. RAE:

- Q And yet in September the financial statements of West Coast showed them to be losing money, ion't that correct?
 - A I never caw a September financial state ...nt.
- Q Where did you got the impression in September that the archery business seemed to be going favorably -- the told you that?

A You pick it up here and there with someone, there was an announcement in the paper, or press stories or Pr.

Scott had mentioned it. I know he was optimicate in the discussion about it, and I just felt that there was something going and I had never seen an archery lane or anything like that, but it looked like it was going to no may-way.

WEST COAST ENGINEERING, INC. 818 S. DAKOTA STREET/SEATTLE 8, WASHINGTON/MU 2-3550

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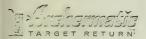
NEWEST OPPORTUNITY FOR PROFIT

Automated Indoor Archerv

AMERICA'S FASTEST GROWING

The second second development of the second second

The controller of set is stance-rangent from in feet to in years. A function is present and the manet mays and to the device distance. Another button is pressed and the target returns to the sending line for easy retrieve of arrows and scoring.



CREATES MASS APPEAL FOR AGE OLD SPORT

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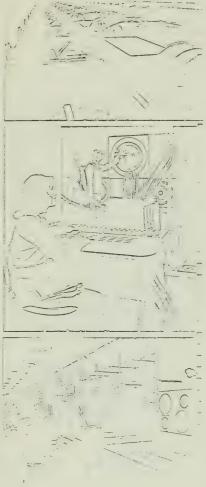
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7 1923 Parking





HERE'S GOOD NEWS

ADOUT

AUTOMATED, INDOOR ARCHERY





KEY TO PROFITABLE INVESTMENTHIGH RATIO OF RETURN

RECREATION—A HIGH PROFIT BUSINESS
—Archery, like bowling, is an extremely high profit business. Like bowling, also, automated, indoor archery requires a substantial initial investment, not only in WCE Archermatic® equipment, but in building and ground. However, an Archermatic® installation, properly located in first class facilities, provides an automshing rate of return.

SPACE REQUIREMENTS — Rule of thumb is 1,000 square feet of building for each lane of archery. This takes into consideration space required for the pro shop, snack bar, playroom for children, restrooms, storage and office space. Depending on local ordinances, parking provision should be made for four to six cars per lane.

SUPPLIES AND EQUIPMENT—All equipment, pro shop inventory and many fixtures based on a study of needs and experience of existing installations, from furniture down to the time clock in the control counter are supplied by WCE.

HOW TO BUY ARCHERMATIC®—Several plans are available for the purchase or lease of Archermatic® automated, indoor archery equipment and related equipment and accessories. Phone, wire or write. A WCE field engineer will make an appointment to explain the plans in detail. Consult Dun & Bradstreet, your attorney or local bank or financial institution for compilete information regarding West Coast Engineering, Inc.

Phone write or wire

WEST COAST ENGINEERING, INC.

818 SOUTH DAKOTA STREET . SEATTLE 8, WASH. . MU 2-3550



WEST COAST ENGINEERING

INTRODUCTION

During the past two years, a brand new era in the highly profitable field of indoor recreation was created by West Coast Engineering, Inc., Seattle, Washington with the introduction of automated, indoor archery.

WCE pioneered the field with its space age contribution to man's oldest competitive sport with the development of the Archermatic. The electronically controlled, automated target return revolutionized the sport when it was installed in modern and attractive indoor archery centers.

Prior to the installation of the first battery of Archermatics in Burien Archery Lanes, Burien, Washington, in September, 1961, WCE spent a year in research, development and testing of the unique target return.

At present, Archermatic, automated target returns with related equipment and accessories designed and manufactured by WCE, are operating successfully in a number of indoor archery establishments. Other indoor archery centers which will contain WCE Archermatics are in various stages of construction or planning.

With the successful creation of the Archermatic, WCE engineers have turned their talents to several other interesting developments in the field of indoor recreation. Operators will soon have several additional WCE recreational components to operate in conjunction with the Archermatic to form a complete and ideal indoor recreational complex.

SEATTLE 8, WASH.
MUTUAL 2-3550

WEST COAST ENGINEERING

WHY INDOOR ARCHERY?

Indoor archery is now in the same stage that bowling was fifteen years ago. How profitable would bowling be today if the bowler had to bowl outside, in daylight hours only and in ideal weather conditions, then walk down after the ball, set up the knocked down pins, retrieve the ball and walk back to the foul line?

In the past, ardent devotees of archery have had to do this very thing: shoot outdoors (if the weather and season permitted), wait until all other archers inished shooting, walk down to the target (usually a bale of hay), score, retrieve their arrows (and help fellow archers look for lost arrows) and walk back to the shooting area again.

Precision engineered Archermatic equipment has changed all this. Today, archers in many cities can shoot any hour of the day or night, regardless of weather conditions, in pleasant, modern, indoorsurroundings, complete with a snack bar and supervised playroom for children, and an archery tackle shop to fill their needs while they are in an archery buying mood.

Indoor archery has grown to the extent that the American Indoor Archery Association, official regulating body composed of independent archers, now regulates games of indoor archery, sanctions indoor equipment and tournaments and performs a public service by educating and indoctrinating many novice and would-be archers.

818 S. DAKOTA ST. SEATTLE 8, WASH. MUTUAL 2-3550

RECREATION ... NEW FRONTIER OF BUSINESS

WEST COAST ENGINEERING

Americans spend between \$40,000,000,000 and \$45,000,000,000 annually in their search for recreation. Shorter work weeks and additional purchasing power now make the field of recreation one of the most attractive for any investor.

From 1952 to 1962, expenditures for participant amusements soared to a 116% increase while the gain in spectator sports was less than 60%.

Today, more than 32,000,000 families, or 69% of all families, have incomes of over \$4,000 annually. This is a gain of 20,000,000 families since 1950.

These statistics are reflected by the tremendous and profitable growth of archery.

With the establishment of indoor archery centers in specially built indoor archery centers, more and more Americans are finding fun and healthy recreation in man's oldest known competitive sport.

The sale of archery equipment in 1963 is predicted to hit almost \$33,000,000. In 1962, archery equipment sales amounted to \$29,300,000.

Since the American public is spending about 6% of its annual income or about \$112,50 per person on amusement and recreation, the potential of indoor archery defies the imagination of any economist.

SEATTLE 8, WASH.
MUTUAL 2-3550

SUPPLY AND EQUIPMENT PACKAGE

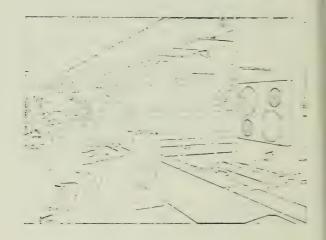
Quantities supplied are based on a study of needs from prior installations together with recommendations from professional archers.

SAFETY TRIM GROUP			co	ST PER LANE
Lane Deflector Shield Electronic Safety Cor Ceiling Deflector and	ntrol System	ing Panels		
	Total		\$	1,300.00
FURNITURE AND FIXTURES				
 Scoring Console Bow and Arrow Rack Scorer Chair Player Seating Spectator Seating Cigarette Floor Um 				
	Total		\$	400.00
LANE RENTAL STOCK				
1. WCE Targ-A-Teer Bov 2. WCE Fleetglass range 3. WCE Targ-A-Teer Qu 4. WCE Targ-A-Teer Ari 5. WCE Tabs	arrows liver	8 per lane 5 doz per lane 4 per lane 4 per lane 4 per lane		
,	[otal		\$	230.00
LANE SUPPLY ITEMS				
Frisco Targets Rainier Targets	20" 5"	1,000 2,500 2,500 2,500 1,000 250 250 250 500 1,000		
•	Total		\$	70.00

GRAND TOTAL PER LANE

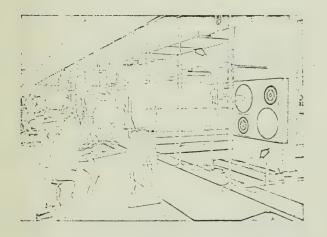
\$ 2,000.00

SAFETY TRIM GROUP



SAFETY TRIM GROUP

Absolutely essential for safe, efficient lane operation. In-cludes two Plexiglas Defloctor Shields providing safe shooting for two archers side by side. Electronic Safety Control System warns operator when an orcher steps over shooting line. Ceiling Deflector provides diffusement of flourescent light while protecting lights from arrows.



WEST COAST ENGINEERING, INC. 818 SOUTH DAKOTA STREET . SEATTLE B. WASH.

FURNITURE AND FIXTURES

SCORING CHAIR

Model 3205 Scoring Chair is a pedestal side chair constructed of "Lifetime" moulded Fiberglas. Rugged aluminum base has rich, satin-like brushed finish. Adjustable from 17" to 19". Self-lubricating nylon bearing, non-marring casters.



BOW AND ARROW RACK

Styled to match scaring console. Contains bow and arrow racking facilities for two adjacent lanes, live archers per lane. Bows with front-mounted sights or stabilizers readily accommodate. Does not affect bow tiller. Lower limb its posts is metal linde races; lower limb its in soft, rubber covered, topered recess. One dozen arrows or WCE quiver can be placed in each of ten tubes in rack top. Design prevents tipping or over turning. 42 inches high by 20% inches wide by 20% inches deep.



SCORING CONSOLE

Provides scoring area and controls mounting for two adjacent lanes. 33 inches high by 37 inches wide by 22 inches deep. Available in a variety of attractive decorator colors and finishes. Highly finished hop prevents burns, scratches. Includes score pad clamps, controls cutout, two removable stainless metal ash trays.



CIGARETTE URN

All metal construction matches decar provided by chairs, scoring console, bow rocks, Large capacity, flreproof receptacle. Receptacle can be emptied into base, 9 Inches in diameter. 19 inches high.



PLAYER AND SPECTATOR SEATING

Decorator colored Fiberglas chairs are compound curved for relaxed seating. Clever interlack allows stable ganging and easy stacking. Resists acids, stains, points. Maintenance free, color permonent.

WEST COAST ENGINEERING, INC. BIB SOUTH DAKOTA STREET . SEATTLE B, WASH.

RENTAL EQUIPMENT

BOW

WCE Targ-A-Teer is the ideal rental bow. Rugged, full working recurve limbs provide full cast, yet are smooth and stable. Handle design fits every archer. Available in all weights, various colors.



ARROWS

WCE Arrows are most economical in initial cost. Permanently straight Micro-Flite Fiberglas shaft with colorful fletching. Crest is color coded for rapid spine and length identification by control counter.



FINGER TAB

WCE shooting tab is of two play, highly finished cordovan. Chrome tonned face ply allows smoother release. Elastic finger loop. Comes in three sizes: Small, Medium and Large.



ARM GUARD

Provides complete and full arm protection for beginners. Foam rubber padded. Hinged for flexibility. Top grade, steel stayed leather covering. Four electic binding straps. Two sizes: Lorge & Small.



QUIVER

Durable leather construction. Nineteen Inches long. Fitted with belt clip. Holds all length arrows for either right or left handed archers. Attractive, expensive design. Defies wear and tear.

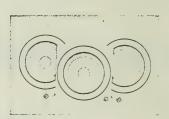


WEST COAST ENGINEERING, INC. 818 SOUTH DAKOTA STREET . SEATTLE B, WASH.

LANE SUPPLY ITEMS

TARGETS

All targets are Official American Indoor Archery Association (aces. Approved for tournament competition and sonctioned for all phases of indoor archery. Targets printed black with white alming spot and scoring rings. 125 lb. test construction corrugated board.



SCORE SHEETS

Two different score sheets for scoring all Official American Indoor Archery Association tournaments and games. Are used also for other games of archery. Specify 4 or 6 arow end game and range imprint.



COST OF INVESTMENT Lease Basis

	12 Lanes	16	20	24
	Lanes	Lanes	Lanes	Lanes
Installation Fee	\$ 700	\$ 700	\$ 700	\$ 700
Supply & equipment package (note 1)	2,000	2,000	2,000	2,000
Total cost per lane for WCE	2,700	2,700	2,700	2,700
Number of Lanes	× 12	x 16	× 20	× 24
Total cost of WCE equipment & installation fee	32,400	43,200	54,000	64,800
Estimated Additional Cash Requirements (note 2)				
Pro shop stock Advertising & promotional funds	5,000	6,000	7,000	8,000
@ \$500 per lane	6,000	8,000	10,000	12,000
Building lease deposit	5,500	7,500	9,000	12,000
Control counter; pro shop fixtures;				
cash registers; office furniture &	, ,,,,,,	7 000	0.000	10.000
fixtures Operating capital	6,000 8,000	7,000 10,000	8,000 12,000	10,000
Operating capital				
	30,500	38,500	47,000	57,000
TOTAL CASH REQUIRED ON LEASE BASIS	\$ 62,900	\$ 81,700	\$101,000	\$121,800
Additional Cash Required for Purchase:		-		
"Archermatics" @ \$7,500 each				
20% down payment required Number of Lanes	\$ 1,500 × 12	\$ 1,500 × 16	\$ 1,500 × 20	\$ 1,500 × 24
Total Down Payment	\$ 18,000	\$ 24,000	\$ 30,000	\$ 36,000
TOTAL CASH REQUIRED ON PURCHASE BASIS	\$ 80,900	\$105,700	\$131,000	\$157,800

- Note 1: The actual cash required may be lowered in proportion to the net worth and/or personal guarantees of the operator. Financing available with sufficient net worth and/or guarantees.
- Note 2: These may vary depending on decor or other capital facilities desired by individual operators.

WCE ARCHERY LANE Income Projections --- Lease Basis

Lancs in Operation
Hours of Operation
Lane hours per day
Lane hours per lane
Per day
Per month
Total customer hours per month
Total customer hours per month
Operation
Total customer hours per month
Optimum Capacity)
21,600

Operating levels (percent of optimum at \$1.25 per hour)		15%	(Note 1) 20%	25%	30%	%56	
Lane rental	∽	4,050	5,400	6,750	8,100	9,450	1
Net profit on pro shop sales (40% profit on sole estimated at 30%							
of lane rents) Equipment rental (12 1/2% of lane rents)		486	648	810	972	1,134	
MONTHLY INCOME FROM OPERATION Less Operating Expenses		5,041	6,723	8,403	10,012	11,764	
NET PROFIT (OR LOSS) PER MONTH ANNUAL PROFIT (OR LOSS) PER MONTH		(1,324)	358	2,038	3,719	5,399	
		(Note 1)	4,270	24,456	44,628	64,788	
Percentage return on \$62,900 Investment			6.8%	38.9%	70 %	103 0%	

30

This 20% of optimum operating time can be achieved merely by operating with two leagues per night from 7 to 11 P.M. for five nights a week and does not take into account the Women and Junior Leagues in the morning and afternoon and the open play on week days and week ends. Note 1:

ARCHERY LANE

Projected Operating Costs - Lease Basis

12 Lane Installation

Building Rent (Approx.) 9¢ per square foot Equipment Rental (\$120 per lane minimum) Salaries (includes \$600 for manager) Sign Lease Lane Supplies (targets, mats, etc.)	\$ 1,080,00 1,440,00 1,900,00 150,00 300,00	
Total		\$ 4,870.00
Expenses:		
Telephone and Telegraph	35.00	
Advertising	500.00	
Insurance	. 60.00	
Car Expense	50.00	
Janitor Expense	75.00	
Taxes	100.00	
Depreciation and Amortization	275.00	
Miscellaneous	100.00	
Heat, Light, Water	250.00	
Accounting Service	50.00	
Total Expenses		1,495.00
TOTAL OPERATING COST	S PER MONTH	\$ 6.365.00

WCE ARCHERY LANE Income Projections --- Lease Basis 16 Lane Unit

		35%		1,470	1,530	15,250	8,140	7,110	85,210	104.3
		30%		1,260	1,312	13,072	8,140	4,932	59,184	72.4
16 240 4 4 960 30	28,800	25%		1,050	1,093	10,893	8,140	2,753	33,036	40.4
n n day nne Jr rrs per month	-	20%		840	875	8,715	8,140	575	9,500	8.5
Lanes in Operation Hours of Operation Lane hours per day Participants per lane Total customer hour per day per month	(Optimum Capacity)	\$ 5,250		630	655	6,535	8,140	(1,605)	(19,260)	
		Operating Levels (percent of optimum at \$1.25 per hour).	Additional Income: Net Profit on Pro-shop sales (40% profit on sale estimated at 30%	of lane rents)	Equipment Kental (12 1/2% of lane rents)	MONTHLY INCOME FROM OPERATION	Less Operating Expenses	NET PROFIT (OR LOSS) PER MONTH	ANNUAL PROFIT (OR LOSS)	Percentage Return on \$81,700 Investment

This 20% of optimum operating time can be achieved merely by operating with two leagues per night from 7 to 11 P.M. for five nights a week and does not take into account the Wamen and Junior Leagues in the morning and afternoon and the open play on week days and week ends. Note 1:

\$ 8,140.00

ARCHERY LANE Projected Operating Costs - Lease Basis 16 Lane Installation

Building Rent (Approx.) 9¢ per sq. ft.

Equipment Rental (\$120 per lane min.)

Salaries (includes \$600 for manager)

Lane Supplies (targets, mats, etc.)	350.00	
Total		\$ 6,285.00
Expenses		
Telephone and Telegraph	35.00	
Advertising	625.00	
Insurance	65.00	
Car Expense	50.00	
Janitor Service	80.00	
Taxes	100.00	
Depreciation and Amortization	450.00	
Miscellaneous	100.00	
Heat, light, water	300.00	
Accounting Service	50.00	
Total Expenses		1,855.00

TOTAL OPERATING COSTS PER MONTH

\$ 1,440.00

1,920.00

2,400.00

WCE ARCHERY LANE
Income Projection --- Lease Basis
20 Lane Installation

20	300	1,200	36,000
Lanes in Operation Hours of operation	Lane hours per day Participants per lane	Total customer hours per day per month	Total customer hours per month (Optimum Capacity)

Operating Levels (percent of optimum at			(Note 1)				
\$1.25 per hour).		15%	50%	25%	30%	35%	
Lane Rental	₩	6,750	000'6	11,250	13,500	15,750	
Additional Income:							
Net Profit on pro shop sales (40% profit on							
sale estimated at 30% of lane rents).		810	1,080	1,350	1,620	1,890	
Equipment Rental (12 1/2% of lane rents).		844	1,125	1,406	1,687	1,968	
MONTHLY INCOME FROM OPERATION		8,404	11,205	14,006	16,807	19,608	
Less Operating Expenses		10,250	10,250	10,250	10,250	10,250	
NET PROFIT (OR LOSS) PER MONTH		(1,846)	955	3,756	6,557	9,358	
Annual profit (or loss)			11,460	45,072	78,684	112,296	
Percentage Return on \$101,000 Investment			11.35%	44.63%	77.90%	111.18%	

Note 1. This 20% of optimum operating time can be achieved merely by operating with two leagues per night from 7 to 11 P.M. for five nights a week and dous not take into account the Women and Junior Leagues in the moining and afternoon and the open play on week days and week ends.

\$ 10,250.00

ARCHERY LANE

Projected Operating Costs - Lease Basis 20 Lane Installation

Building Rent (Approx.) 9¢ per square foot Equipment Rental (\$120 per lane minimum) Salaries Sign Lease Lane Supplies (targets, mats, etc.)	\$ 1,800.00 2,400.00 3,200.00 200.00 550.00	\$ 8,150.00
Expenses:		
Telephone and Telegraph Advertising Insurance Car Expense Janitor Service Taxes Depreciation and Amortization Miscellaneous Heat, light, water Accounting Service	60,00 625,00 80,00 60,00 200,00 125,00 450,00 100,00 350,00 50,00	
Total Expenses		2,100.00

TOTAL OPERATING COSTS PER MONTH

24 Lane Installation

24	360	1,440	43,200
Lanes in Operation Hours of Operation	Lane hours per day Participants per lane	iotal customer hours per day per month	Total customer hours per month (Optimum Capacity)

Operating Levels (percent of optimum at			(Note 1)				
\$1.25 per hour).		15%	20%	25%	30%	35%	
Lane Rental	~	8,100	10,800	13,500	16,200	18,900	
Additional Income: Net Profit on pro shop sales (40% profit							
on sale estimated at 30% of lane rents).		972	1,296	1,620	1,944	2,268	
Equipment Rental (12 1/2% of lane rents).		1,012	1,350	1,687	2,025	2,362	
MONTHLY INCOME FROM OPERATION		10,084	13,446	16,807	20,169	23,530	
Less Operating Expenses		12,150	12,150	12,150	12,150	12,150	
NET PROFII (OR LOSS) PER MONTH		(2,066)	1,296	4,657	8,019	11,380	
Annual profit (or loss)			15,552	55,884	96,228	136,560	
Percentage return on \$121,800 Investment			12.76%	45.88%	29.00%	112.11%	

36

Note 1. This 20% of optimum operating time can be achieved merely by operating with two leagues per night from 7 to 11 P.M. for five nights a week and does not take into account the Women and Junior Leagues in the morning and afternoon and the open play on week days and week ends.

ARCHERY LANE

Projected Operating Costs - Lease Basis

24 Lane Installation

Building Rent (Approx.) 9¢ per square foot \$ 2,340.00 Equipment Rental (\$120 per lane minimum) 2,880.00 Salaries 3,400.00 Sign Lease 200.00 Lane Supplies (targets, mats, etc.) 600.00	
Total Expenses:	\$ 9,420.00
Telephone and Telegraph 75.00	
Total Expenses	2,730.00

TOTAL OPERATING COSTS PER MONTH

\$ 12,150.00

WCE ARCHERY LANE Income Projection --- Lease Basis 24 Lane Installation

	35%	18,900	2,268	23,530	11,380	136,560	112.11%
	30%	16,200	1,944	20,169	8,019	96,228	79.00%
42041 001 011	25%	13,500	1,620	16,807	4,657	55,884	45.88%
360 360 360 1,440 30 4 4 43,200	(Note 1) 20%	10,800	1,296	13,446	1,296	15,552	12.76%
ay ne rs th rs per month ity)	15%	8,100	972	10,084	(2,066)		
Lanes in Operation Hours of Operation Pare hours per day Participants per lane Total customer hours per day per day per day per day per day (Optimum Capacity)		•					
	Operating Levels (percent of optimum at \$1.25 per hour).	Lane Rental	Additional Income: Net Profit on pro shop sales (40% profit on sale estimated at 30% of lane rents), Equipment Rental (12 1/2% of lane rents).	MONTHLY INCOME FROM OPERATION Less Operating Expenses	NET PROFIT (OR LOSS) PER MONTH	ANNUAL PROFIT (OR LOSS)	Percentage return on \$121,800 Investment

Note 1. This 20% of optimum operating time can be achieved merely by operating with two leagues per night from 7 to 11 P.M. for five nights a week and does not take into account the Women and Junior Leagues in the morning and afternoon and the open play on week days and week ends.

ARCHERY LANE

Projected Operating Costs - Lease Basis

24 Lane Installation

Building Rent (Approx.) 9¢ per square foot Equipment Rental (\$120 per lane minimum) Salaries Sign Lease Lane Supplies (targets, mats, etc.)	\$ 2,340.00 2,880.00 3,400.00 200.00 600.00	
Total		\$ 9,420.00
Expenses:		
Telephone and Telegraph Advertising Insurance Car Expense Janitor Expense Taxes Depreciation and Amortization Miscellaneous Heat, light, water Accounting Service	75.00 800.00 100.00 80.00 300.00 150.00 525.00 150.00 450.00	
Total Expenses		2,730.00
TOTAL OPERATING COSTS PER MONTH		\$ 12,150.00

BURIEN ARCHERY LANES 15701 Ambaum Boulevard Seattle 66, Washington





Archermatic prototype was installed at Burien.





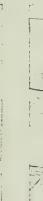
Industrial league archers check their scores.

an installation of WEST COAST ENGINEERING, INC. 813 South Dakota St. Seattle 3, Washington

GOLDEN ARROW ARCHERY LANES 2200 West Alameda Denver, Colorado







Small fry receive the same expert instruction



an installation of WEST COAST ENGINEERING, INC. 313 South Dakota St. Seattle S, Washington

ARCHERYLAND 10015 Southeast Stark St. Portland, Oregon



League archers display their intense concentration.



Expert planning resulted in a beautiful exterior.



The well stocked pro shop is a profitable adjunct.

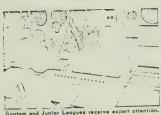


an installation of COAST ENGINEERING, INC. 818 South Dakota St. Seattle 3, Washington

GOLDEN ARROW LANES OF COVINA 5136 N. Citrus Ave. Covina, California



The 1962 NFAA Champion, Don Cavallero, is the Golden Arrow pro.





Golden Arrow pro shop is functional and pr

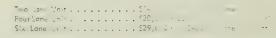


an installation of WEST COAST ENGINEERING, INC. 818 South Dakota St. Seattle 8, Washington

TRAPOMATIC BY WCE

Price Lit

ALP





SUGGESTED HOUSEY 1 ATES

One	person	per	lane	٠	٠						Sc	
Two	persons	per	lane								\$4.00	C
Three	persons	per	iane								52.00	c .h
Four	persons	per	lane								\$2.00	0.00

TRAPOMATIC BY WCE

EQUIPMENT INCLUDED PER LANE:

WEST COAST ENGINEERING

Booth - Complete with shot-resistant, safety Plexiglas panels; wood and steel laminated safety dividers; pneumatic sliding safety door with sensing switch edge; safety switch mats to operate safety door; shooting counter complete with sliding service doors to the equipment and mar resistant top; shooter's table.

SEATTLE 8, WASH.
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- Pigeoneer Automatically fed magazine and target storing device which stores up to 3,400 birds and feeds them to the target conveyor complete with electrical control gear.
- Target Conveyor Complete with motorized starter, air blower and pick-off mechanism to feed targets to the projectors.
- Target Projectors Two to a unit. Complete with pneumatic and electric control mechanisms to automatically project birds into the shooting area.
- Air Compressor To supply compressed air to the Trapomatic system.

 Motorized, complete with starter.
- Shotguns Three .22 caliber pump action, ventilated rib non-recoil shotguns per lane complete with safety tethering and warning devices. Custom stocks for children and adults.
- Field Murals One complete set of four color wall murals for two side and rear walls of the shooting area from booth line to rear wall. Sectionalized for simple replacement. Adds dimension and realism to shooting area.
- Dimensional Shrubbery, Sound Absorbing Floor Cover Shrubbery adds realism and depth to shooting area. Floor covering assists in absorbing sound.
- Protective Net Fine nylon net to protect rear wall from damage by flying targets. Does not affect image provided by wall murals.
- Control Console Central switch panel and warning system to control all mechanisms in each booth and lane.

TRAPOMATIC - FURNITURE AND ACCESSORIES (Optional)

WEST COAST ENGINEERING

Spectator Seating
Cigarette Urns
Operating Supplies (purchased from WCE as needed by operator)
Ammunition - .22 caliber long rifle bird shot in case lots.
Targets - Clay pigeons in case lots.
Score Pads
Awards

STATTLE 8 WASH.

OPERATOR SUPPLIES AND INSTALLS:

- Sound reducing side and rear walls of the shooting area to WCE drawings and specifications.
- 2. Sound reducing ceiling with provision for concealed flourescent lighting to WCE drawings and specifications.
- 3. Painted ceiling surface to WCE specifications.
- Flourescent ceiling lighting for the range area, booths and spectator area to WCE drawings and specifications.
- Finished and trimmed booth headers from which WCE installation crew suspends booth. To WCE drawings and specifications.
- 6. Power supply to the adjacent room for the Pigeoneer magazine to WCE drawings and specifications.
- 24 volt control wiring from room in which the Pigeoneer magazine in installed to control console. WCE to supply wire and connection. Operator installs.

WEST COAST ENGINEERING

TRAPOMATIC BY WCE Estimated Expenses

4 Trap Unit

BIE S. DAKOTA ST. SEATTLE B, WASH. MUTUAL 2-3550

Sciaries	\$ 650.00
Rent	500.00
Unities	100.00
Janitorial Services	50.00
Depreciation (Note 1)	170.00
Insurance	25.00
Miscellaneous	 50.00
Total Monthly Expenses (Note 2)	\$ 1,545.00

Note 1: This is on a straight line basis and may be taken at any of the accepted accelerated rates.

Note 2: Total expense in cases where trap is run in conjunction with a bowling alley or archery range. Much of the expense would be on a percentage allocation of the total expense with the addition of one part time helper, e.g., 24 lane archery center monthly expenses \$12,500.00

10% allocated to Trap 1,250.00 1/2 person additional 300.00 \$ 1,550.00

WEST COAST ENGINEERING

TRAPOMATIC BY WCE Estimated Income Projection

4 Trap Unit

Number of Traps Hours of operatio Trap hours pe Days per mor Optimum custome per month	n per day er day nth	4 15 60 30 1,800		BIBS, DAKOTA ST. SCATTLE B, WASH. MUTUAL 2-3550
Percentage of optimum capacity	10%	15% (Note 1)	20%	25%
Rental income @ \$8.00 per hour Less: Optimum Expense	1,440	2,160 1,545	2,880 1,545	3,600 1,545
GROSS MONTHLY PROFIT (OR LOSS) GROSS ANNUAL PROFIT (OR LOSS)	(115) (1,380)	615 7,380	1,335 16,020	2,055 24,660
Return on Investment of \$22,000		33.55%	72.71%	112.1%

Note 1: 15% of Optimum is operating each unit 2.25 hours per day.

TRAPOMATIC BY WCE

WEST COAST ENGINEERING

Estimated Income Projection

4 Trap Unit

BIB S. DAKOTA ST. SEATTLE E, WASH. MUTUAL 2-3550

15%	20% (Note 1)	25%	30%
2,160 1,545 648	2,880 1,545 864	3,600 1,545 1,080	4,320 1,545 1,296
(33) (396)	471 5,652	975 11,700	1,479 17,748
	25.7%	53.2%	80.7%
	2,160 1,545 648 (33)	(Note 1) 2,160	(Note 1) 2,160

- Note 1: This 20% of optimum operating time can be attained merely by operating with leagues from 7 to 11 P.M. five nights a week and does not take into account the Women and Junior Leagues in the morning and afternoon and the open play on week days and week ends.
- Note 2: Cost of clay birds has been calculated at .008 each. Expense projected on five birds per minute maximum shooting capacity.
- Note 3: The above projection does not reflect the expense incurred or the income generated by the sale of ammunition to shooters. It is suggested the ammunition be bought in quantities where the most ideal discount can be obtained and sold to the shooter at a little above cost to offset the expense of handling.



WEST COAST ENGINEERING, INC. Officers, Directors and Key Personnel

Bryan J. Dickinson --- Seattle, Washington

President, General Manager and Director. Age 39. Mechanical, Design and Industrial Engineer. Former Manager, Northwest Bionch, Eimo Corporation; Manager, Tungsten Carolide Bit Division, Hoist and Loader Division; Project Manager, Mining and Construction Division of Joy Manufacturing Company. Invented and designed WCE Automatic Indoor Archery equipment.

Jack D. Gay ---- Seattle, Washington

Vice-President and Director. Also Treasurer and Director of Silver Buckle Mining Company and partner of Gay & Scott, Investments. Age 45. Accountants. Formerly President of Sage Lumber Company and Treasurer of Northwest Uranium Mines, Inc.

Dr. F. E. Scott ---- Wallace, Idaho

Secretary and Director. Also President and Director of Silver Buckle Mining Company, partner of Gay & Scott, Investments. Age 62. Dentist. Mining executive in many mines past 30 years.

Nolan Brown ---- Cheney, Washington

Treaurer and Director. Also Director of Silver Buckle Mining Company; partner and officer and director in Brown and Holter Automobile Agencies; Brown & Holter Investment Co., Shadle Park Shopping Center, etc. Age 54. Businessman.

Willard J. Dziuk ---- Burien, Washington

Director. Partner in Burien Archery Lanes. Age 44. Retail business background. Operated Standard Oil Station in Des Moines with Clark Conrad for 15 years.

Richard Crawshay ---- Seattle, Washington

Plant Manager. Age 40. General engineering, management, shop and maintenance background. Formerly Works Manager, Letton & Burbee, manufacturers of pulp and paper and miscellaneous engineering products, Vancouver, B. C.

mir - ---

Roy L. Sender --- Seattle, Washington

Office Manager. Age 32. Accountant. Formerly with Heath Manufacturing Co. and Diamond Enterprises.

Al Osbom ---- Seattle, Washington

Sales Manager. Age 47. Sales and brokerage background. Formerly with M. A. Cleek and Co. and Pennaluma & Co.

George Keeney ---- Seattle, Washington

P. R. and Advertising Director. Age 40. Advertising. Twenty years experience in P.R. and advertising work as account executive and as owner of own firm.

Mackenzie Yager ---- Belmont, California

West Coast Sales Monager - age 58. Twenty-four years experience as Sales Engineer for Brunswick Corporation.

Harold Duncanson ---- Seattle, Washington

Plant Superintendent. Age 55. Extensive shop and manufacturing and equipment experience.

Harold Zirkel ---- Seattle, Washington

Field Installation Superintendent. Age 62. Extensive operating and management experience in heavy construction equipment.

Dale Marcy ---- Seattle, Washington

Archery Supply Manager, Age 3. Extensive sales experience in archery tackle. Professional Archer, Formerly bowyer for Howatt Bows.

Claude Hudson --- Seattle, Washington

Purchasing Agent. Age 45. Twenty years experience in purchasing for light manufacturing.

Howard Hill ---- Los Angeles, California

Sales and Lane Promotion. Age 60. Forty years in archery. Has made dozens of movies on archery including full length feature "Tembo" in full color of hunting big game in Africa. All films available to West Coast. Known in

Bonnie Young ---- Seattle, Washington

Lane Promotion. Age 50. Twenty years experience in organizing telephone "boiler-rooms" to fill bowling lones with league players. Has successfully converted techniques to archery.

John McPhelan ---- Los Angeles, California

Southern California Branch Sales Manager. Age 35. Five years experience as Sales Engineer with Brunswick Corporation.

September, 1962

HOWARD HILL IS STAR OF ARCHERY EXPERTS

Howard Hill is known around the world as Mr. Archery -- and a glance at his record makes it easy to see why.

He's also known as "the greatest bowhunter of all time," "the Babe Ruth of archery" and "the old master".

Through a lifetime devoted to the sport -- in movies, radio, television, magazine articles and books -- he has become known as a living symbol of skill and achievement in archery.

His movies include 23 shorts for Warner Brothers, and all the actual archery shooting in "Robin Hood," "Elizabeth and Essex," "They Died With Their Ecots On," "Dodge City," 'Virginia City," "Buffalo Bill" and "Bandito of Sherwood Forest." He also made "Tembo" in Africa, which has been shown in 57 countries in seven languages.

Hill has hunted in 12 countries and taken more than 2,000 head of big game. He was the first white man known to slay an elephent with a bow and arrow.

Eill has thrilled millions with his exhibition shooting, including appearances at three world fairs. His dramatic demonstrations include hitting a coin tossed in the air and other equally difficult moving targets.

In organized erchery competition, Hill won 196 consecutive Field Archery championships, although he modestly denies he is a "national champion" in the usual sense.

His arrows used in filming "Robin Hood" and his books and pictures are on permanent display in the Helms Athletic Foundation Hall of Feme.

BRYAN J. DICKINSON SPEAKS ON ARCHERY

"The field of recreation is the most promising one in our immediate future. With more and more time available -- up to a third of our total time -- spent in recreation, the public must be offered more to do which contributes to the fundamental values of our lives. Archery is an excellent beginning for WCE, for this sport is truly a family activity and one which offers young people an outlet that is cleen, safe and healthful."

"Like the sprinter, WCE will not lose its stride or chance a fall by looking over its shoulder to see where the competition is. We're going to hold our lead and finish the race in first place."

"Our attitude is one of a better and healthier mental condition.

Breaking the four-minute mile has become common -- once Man decided he could do

it. We take the attitude we can accomplish, as a firm, in four or five months
what normally would take two years to do -- and we're doing just that."

"About 90 per cent of the people take part in summer recreation -and tend to sit idle all fall and winter. Archery is a natural enswer, fulfilling
so many basic needs as well as being a perfect outlet for those frustrations
and pent-in emotions with which we all are plagued."

September, 1962

BRYAN J. DICKINSON BRINGS
BROAD EXPERIENCE TO W.C.E.

Twice in recent years chance has led to radical changes in the life of Bryan J. Dickinson.

The first time was in Los Angeles in 1960, when he was struck by a bus and seriously injured.

Faced with a long convalencence, he resigned his post as design engineer and product manager for Joy Manufacturing Co., where he had enjoyed three years of notably successful career with the large machinery and equipment firm, and moved his family to Seattle to regain his health and start life anew.

That step, coupled with his talents and experience, set the stage for the luckier accident of his driving into a service station near his new suburban name to find the operators, Willard Dziuk and Clark Conrad, engaged in archery practice in their garage area.

The resultant conversation about archers' universal wish for errow return and a systematic means of year-around and night shooting was the beginning spark leading directly to Dickinson's production of the Archermatic line of fully automated indoor archery equipment developed through West Coast Engineering, Inc., which he formed October 6, 1960 for that purpose and heads today in president.

Dickinson, at the age of 40, has almost 20 years of experience in all major phases of mechanical engineering, including market analysis, sales consecuent, development and production.

After receiving his engineering education at Oklahoma Military Academy and the University of New Mexico, he opent four years in military service during forld War II and was commissioned to pilot four-engine planes.

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Following a partnership in a successful truck and trailer sales business in Albuquerque, N.M., he was employed as a mechanical engineer by three affiliated firms, Spokane-Idaho Mining Co., Silver Crescent Lessing Co., and Con.isc. is Mining Co., which brought him to the Northwest and in turn led to two years in Mallace, Idaho, as branch manager for Miller Machinery Co.

In 1949 he joined the Eimco Corp. as branch manager headquartered in Smottle, with respect 1 May 12 cm. and 12

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DENVER'S GOLDEN ARROW LANES OPEN WITH CERRAMONY SEPT. 29

A bright new era in America's family recreation will be launched Sept. 29 with formal opening of Golden Arrow Archery Lanes in Denver, Colorado.

The fully automated indoor archery center is located in Alameda Shopping Center, 2200 W. Alameda.

The 32-lane range, coffee shop, nursery and pro shop, occupying 33,000 square feet, represents on investment of approximately \$320,000.

All equipment in the center is engineered, manufactured, installed and maintained by West Coast Engineering, Inc., of Scattle, and bears the registered trade name Archermatic.

Owner of Colden Arrow Archery Lenes is Bow-ing, Inc., a Coloredo corporation headed by C. K. Dillon, president, of suburban Littleton, Colo.

Nick (Spike) Clayssens, veteran Denver bowling figure, is general manager of Golden Arrow Archery Lanes, coming to his new post from managership Celebrity Sports Center since it opened in Denver in 1960.

Harold (Hal) Carmichael, owner of Hal's Sporting Goods in Denver, is manager of the pro shop.

Carmichael is one of only three professional archers in Colorado, and he also will head the competent archery instruction staff.

Robert E. McKelvey, formerly night food and beverage manager at Celebrity Sports Center, is manager of the Golden Arrow restaurant.

Coremonies and festivities marking the opening of Golden Arrow Archery Lance begin with daily invitational previews starting September 26 with a press gathering and climaxing with a gala ribbon-cutting ceremony Saturday, September 29, to welcome the public to the first of a series of such new automated indoor strchery centers across the nation.

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ARCHERMATIC INSTALLATION PACKAGES LANE PROFITS

West Coast Engineering. Inc., delivers a complete package tailored for profits when it cells an Archermatic installation.

The package includes everything to put and keep the archery center operator in business.

Included is training of parameter, advertising and promotion, protho; stocks, remail equipment and quadrature results forms, heavier needing to
chance.

Operators are brought to Seattle for thorough indoctrination in every detail, from design, fabrication and maintenance of all Archermatic range equipment to programming personalized cooperative public relations for their own locale backed up with strong national advertising.

Meanwhile, professional archery instructors are nominated to the exerctor, along with complete lines at anchory tackie and related mercularise for the pro shop and all the essential equipment for the coffee shop, nursery and control counter, right down to time clock and cash register.

The recommended Grehery center condition of at least 24 lanes. Such a complete installation costs on average of \$170,000, and is available on either a lease or purchase basis.

"We went and expect the operator to enjoy a high return on his investment." Mys Jayan J. Disminson, president of MCE. 'We have gained transmissably
valuable experience in the prototype Burien Archery Lanes operation, and the
comp way we can offer an investor an efficient, profitable business is to work
closely with him -- every step of the way."

DENVER OPENING SEPTEMBER 29 MARKS START OF BIG ERA

With a year's operation of prototype lenes and tooling up behind it now, West Coast Engineering, Inc., this month launches into a bright new phase offering America great new opportunities for family recreation -- automated indoor archery.

Golden Arrow Archery Lanes, a 32-lane range in Denver, Colorado, opens September 29.

Archery Land, a 24-lane installation in Portland, Oregon, opens October 27.

Two more archery centers in the Los Angeles area (Covina and Downey, Calif.) and one in the San Francisco area (Redwood City, Calif.) will open before the end of 1962.

Additional openings early in 1963 are scheduled in San Diego, Denver, Fortland, San Francisco, Dallas, Houston and Phoenix.

By mid-1963, according to the WCE production schedule today, there will be 17 more archery lanes installations opened in California plus 30 more in Midwest cities.

Bryan J. Dickinson, president of WCE, says:

"A conservative projection of our situation today looks very healthy, indeed. We should achieve more than 100 installations by the end of 1963. It is conceivable that by the end of 1964 we can double our output for a total business of \$100,000,000 during the next two years."

-000-

WEST COAST ENGINEERING RISE IS SWIFT, SWEET

West Coast Engineering, Inc., of Seattle was formed in 1960 as a manufacturers' representative organization with plans to research and develop recreational products of its own.

Its founder and president is Bryan J. Dickinson.

At the outset the firm was headquartered in modest leased space at 2427 Sixth Avenue South, Sestile.

Interest and emphasis on archery came about accidentally when Dickinson drove into a service station near his home and found the operators, Willard Dziuk and Clark Conrad, bowing arrows into a target in their station's garage.

The conversation disclosed Dziuk and Conrad were professional archers as well as archery lobbyists, and they explained to Dickinson archero' age-old yearning for some sort of effortless arrow return, plus the potential of also moving the sport indoors for year-ground and night play.

Dickinson applied his engineering creativity to the challenge of the problem that had frustrated sporting archers since the Stone Age.

Within six months his firm was fabricating some of the automated rease equipment, and in September, 1961, the Burien (Wash.) Archery Lance were opened as a prototype installation of fully automated indoor archery.

Dickinson recognised he needed a "track record" operation if he was to attract investors to the sport, so a market survey was launched.

Within six months he knew he had something that would sell -- and West Const Engineering, Inc., held 33 basic patents on the equipment.

2.

One year of the Eurien Archery Lones operation proved the feasibility of investment, which averages out now to approximately \$170,000 for each range location of 24 lanes.

Further financial studies indicated the need for both capital and plant expansion.

To accomplish this, West Coast Engineering, Inc., was placed in a stock option affiliation with Silver Buckle Mining Co., Inc., of Ideho, and the offices and production were shifted to a 36,000-square-foot building at 818 South Dakota Street, Seattle.

Today West Coast Engineering, Inc., has 100 employees on a payroll of about \$50,000 a month.

Although current efforts are devoted almost exclusively to development and production of Archermatic equipment -- copyrighted trade-name of WCT automated indoor archery equipment -- additional expansion of both plant and personnel is anticipated.

Also, further growth also is imminent with well-advanced current development of Trapomatic, a companion line of automated inseer transshorting equipment.

Today's orders at hand -- franchise options secured by substantial cash deposits tied into opecific performance contracts -- give WCE five ranges installations embracing 128 lanes opening before the end of 1962, plus opening of 34 other ranges totalling about 768 lanes scheduled already for 1963.

From a tested idea to a backlog of some \$7,000,000 worth of orders in cir months -- that's today's story of MCD.

ARCHERY HAS BIG POTENTIAL AS SPORT AND INDUSTRY

Today there are approximately 3,600 archery clubs in the U.S. with a total active membership estimated at 7,500,000 persons.

Retail sales of archers' equipment are in third place nationally, following only fishing tackle and ammunition, according to a recent survey by a trade magazine, Sporting Goods Dealer.

As a family-appeal sport, archery today falls in sixth place --boating with an estimated 37,000,000 participants; bowling, 28,000,000;
bicycling, 27,000,000; camping, 22,000,000; hunting, 18,000,000; archery,
7,500,000; tennis, 6,700,000; golf, 5,400,000; water-aking, 5,000,000.

Adding automation to archery, and extending the season and hours of abooting by moving it indoors, should increase the number of archers five-fold, according to Bryan J. Dickinson, president of West Cosst Engineering, Inc.

"If bowling is any measure, it indicates there is room for nearly 50,000 archery lanes in the U.S.," Dickinson says. "We are shooting for only 10 per cent of that figure in the next five or six years. I see no reason to believe we will fall short of our target."

A goal of 5,000 archery lane installations means a total volume of business of \$850,000,000 for SCE, according to Dickinson.

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OPENING PROGRAM GOLDEN ARROW ARCHERY LANES ALAMEDA SHOPPING CENTER DENVER, COLORADO

Tuesday September 25 9:00 P.M.

Alameda Shopping Center party. The purpose of this is to acquaint all employees and numbers of businesses in the Shopping Center with Golden Arrow Archery Lanes and with the games of arener, A short program including the movie, "Archery for Everyone"; a full explanation of tiein promotions and announcement af-advertising and promotional program will be included. Every perhave a change to shoot for prizes. In this manner, the operating personnel of the lanes will have a chance to get acquainted with all of the employees of the Shooping Center and will be able to exilain archery so that they in turn will be able to answer questions of the customers. Howard Hill and Mary troming will put on an exhibition. Coffee and a light snack will be srived.

Wednesday September 26 7:00 P.1/4.

Press party. This will include all members of the communications inaustry as well as free-lam e-public retarions and advertising peomic. All employees of all ratios stations, news apers, TV stations, out-agon companily, etc., will be invited. Everyone will learn to shoot the bow and no wo are will participate in competition for prizes. Press kirs will be destributed; gomes of archery est, a see, the time. "Anothery for Everyone" shown, and movers mill another the station of prizes, the section of the will be open and dancing to a combo will conclude the evening.

Thursday September 27 7:30 P.A.

Strings because night. All business and civic lenders, charth, YMCA, YCCA, schoor, scout and sport, coders will be invited. Everyone present will be invited and process of an given a chance to shoot and a process membrasizing the family, league and youth conceins will be resented. Actin, prims will be avareed in those shooting for the tirst time; the gones of archery explained, and fact sheets distributed actaining the land, partion as well as for it in the conceins the land, partion as well as for it in the conceins the land, partion as well as for it in the conceins the land, partion as well as for its interference.

Fridoy

September 28

7:00 P.M.

Grand Opening. Invitations will be sent to all top besiness and political leaders in the area. A prief aedication coremony with be held followed by a shoot-off of the featured algorithms. Government of Washinston and Colorate, if possible, the engrammoid of followed by entertainment and an entitation by Howers mill, Many derrine and Kathy Duncan. This exhibition will, see a bill sometiff on between Mory Horline, though matter that Junior Champion, and the Colorate in the surface of the shoot of the colorate will be a surface of the shoot of the colorate will be a surface. This will be followed by a buffet and dencing to conclude the evening.

Saturaay Sunday September 29 through October 14

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Popule Opening during which time all beninning snooters will be given free instruction one 13 minutes are shooting time. At reast 2 lanes will be accorded to this answer of the program of minutes are public opening. Also, we will include showings of movers the movies one organization of the program of the control of the

 Note: Hostesses for the Business leaders night and for the Grand Opening will be the steem body officers of the two exclusive girls' schools in Denver.

DENVER OPENING SEPTEMBER 29 MARKS START OF BIG ERA

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All equipment in the center is engineered, manufactured, installed and maintained by West Coast Engineering, Inc., of Seattle, and bears the registered trade name Archermatic.

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1962 ANNUAL REPORT . WEST COAST ENGINEERING, INC.



WEST COAST ENGINEERING, INC.

1962 ANNUAL REPORT

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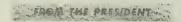
Accountants' Report

The Indoor Recreational Complex

Research and Development

Manufacturing

Marketing



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Along with a substantial increase in gross sales, cost of goods sold decreased encouragingly despite a heavy load of initial developmental costs and a number of cost of goods sold sold goods sold during the twelve month period ending February 28, 1963 was 54.5%. For the fourteen month period ending February 28, 1963 was 54.5%. For the fourteen month period ending February 28, 1963 was 56.5%. Cost projections for the coming year indicate a more substantial reduction than the 31% reduction between

Responsible for the healthy increase of gross sales was the installation of 120 lanes of Archermatic automated indoor archery equipment and related accessories in Burier, Washington; Denver, Colorado; Portland Oregon; Downer, and Coving, California.

Another significant comparison: Sales and administrative costs of \$567,274.10 were charged against Archermatic sales to the five automated, indoor archery centers presently in operation. Under generally accepted auditing standards, each sale cost approximately \$113,454.

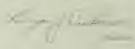
If these expenses had been charged against the 20 additional sales actually made but not installed to date, cost of each sale would be only \$22,691.

It must be noted that many of the expenses made during the past twelve month period are those which will not occur again for some time. In building a national manufacturing and sales organization, the cost of training personnel, developing products and protrional material is highly expensive. This is normal in almost any type of new business.

THE YEAR AHEAD

\$5,000,000 worth of orders for Archematic automated indoor archery equipment and related accessories have been accepted thus far. Installation will be made in California, Kansas, Kentucky, Indiana, Oklahoma, Ohio, New York and Connecticut.







INTRODUCING THE TRAPOMATIC

The Trapomatic automated, indoor trapshoot will be placed on the market this year. Conservative projections point toward the sale of forty-eight booths of Trapomatic in the year ahead. The initial installation of four booths of Trapomatic will be made at Golden Arrow Archery Lanes, Denver, Colorado and should be in operation by June, 1963.





BURIEN ARCHERY LANES 15701 Ambaum Blvd. S.W. Seattle, Washington

The prototype installation was made at Burien Archery Lanes and opened in September, 1961. A close scrutiny of its operation and promotional schedule was made to supply this information to future installations. Buren is now an established business. A healthy increase in the number of archery league players is now found at Burien compared to the number of consistent league players last year.



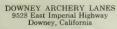
GOLDEN ARROW ARCHERY LANES 2200 West Alameda, Denver, Colorado

Thirty-two lanes of indoor automatic archery were opened to the public in September, 1962. Located in one of the largest existing shopping centers in the Denver area, it is the largest indoor archery center in the world. Four lanes of Trapomatic will be installed at Golden Arrow and will be open to the public by June, 1963.



ARCHERYLAND 10015 Southeast Stark, Portland, Oregon

Opened in November, 1962, Archeryland has one of the most attractive exterior designs of any of the existing installations. Archeryland was first to establish the existing pattern of twenty-four lanes of Archermatic as an average size indoor archery center. Archeryland was also first to locate in a popular suburban area of a metropolitan city.



The Downey Archery Lanes opened in December, 1962. It is located in a heavily populated suburb about twenty miles from Los Angeles proper near Long Beach. The Downey public opening successfully utilized a one hour television show televised "live" from the lanes. The Downey pro shop set a profitable pattern of operation that is being followed closely by all installations.





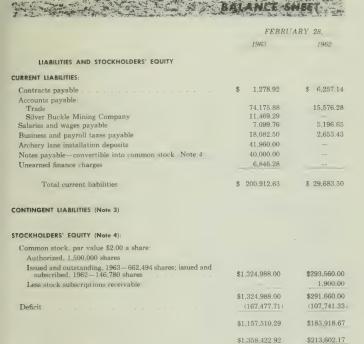
GOLDEN ARROW ARCHERY LANES OF COVINA

5136 North Citrus Ave., Covina, California

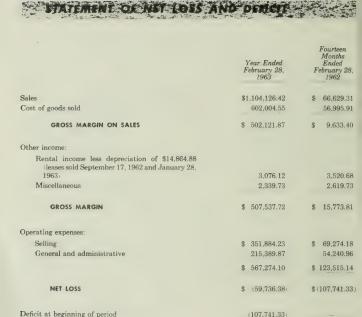
Also opened in December, the Golden Arrow Archery Lanes of Covina has the distinction of having what many term the most beautiful interior design and decor of any of the indoor archery centers. The Covina corporation is planning several more indoor archery centers in Southern California.



		FEBRUARY 28,	
		1963	1962
ASSETS			
CURRENT ASSETS			
Cash	\$	163,281.13 31,750.27	\$ 66,465.8 1,746.0
Trade accounts receivable less allowance for doubtful accounts, 1963-\$5,940.00; 1962-\$1,423.32)		95,311.02	9,288.:
Current portion of installment contracts receivable . Inventories (at the lower of cost, on the first-in first-out		16,571.00	_
basis, or market			
Merchandise for resale		26,317.22	9,079.
Installations in progress		206.364.98	2,471.
Advances and prepaid expenses		27,686.20	2,630.
Total current assets		567.281.82	\$ 91,680.
NVESTMENTS (At Cost) AND OTHER ASSETS:			
Investment in Silver Buckle Mining Company stock— parent company (market \$1,600,000; underlying book value \$386,000)	\$	571,428.00	
value \$386,000) Other investments	4	3,750.00	_
Rental archery lanes installation (less accumulated depreciation of \$7,849.32)		_	\$ 48,897.
Installment contracts receivable (less portion included in current assets above)		34.854.88	_
Unamortized research, development and organization costs			51.050
Note 1) Unamortized patent costs and patents applied for		122,429.70 19,228.89	51,956.3 3,432.9
	\$	751,691.47	\$104,286.
QUIPMENT AND LEASEHOLD IMPROVEMENTS 'At cost less			
accumulated depreciation and amortization, 1963-			
\$15,412.09: 1962—\$5,781.87		39,449 63	17,634.
	\$1	,358,422.92	\$213,602.



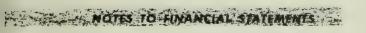
Deficit at February 28



See notes to financial statements

\$ (167,477.71)

\$(107,741.33)



YEAR ENDED FEBRUARY 28, 1963

NOTE 1 ACCOUNTING POLICIES

The Company ofers indoor archery equipment installations to the public on either a seven year lease or an outright sale arrangement. Costs of these installations are charged to operations if they are sold or capitalized and depreciated over an eight year period if they are leased.

Archery equipment research and development costs have aggregated \$94,943 10. In addition the Company has incurred costs of \$47,537,97 in the development of indoor trap shooting equipment. Such costs are amortized over five year periods as incurred. However, under provisions of Internal Revenue Code Séction 174, the Company has elected to deduct such costs in the year incurred for tax purposes.

NOTE 2—FEDERAL INCOME TAX STATUS:

The net loss of the Company for Federal income tax purposes from inception to February 28, 1963 amounts to approximately \$290,000.00, which loss may be carried forward to apply against future taxable income through December 31, 1967.

NOTE 3-CONTINGENT LIABILITY:

All installations to date have been leased and subsequently sold to finance companies requiring repurchase at the end of the lease period.

The aggregate of repurchase prices of all installations is \$77,001.

As of February 28, 1963, the Company's contingent liability under terms of recourse agreements requiring repurchase of leaseed archery lane installations, in the event of default by the lessees, was approximately \$837,000.00, All of the shares of Silver Buckle Mining Company stock registered in the name of the Company have been deposited in escrow as security to assure performance under the terms of the recourse agreements.

The Company is also contingently liable under the terms of an assignment of a lease relating to premises formerly occupied at 2427 - 6th Avenue South. Seattle. Washington, amounting to approximately \$15,500.00.

NOTE 4—COMMON STOCK HOLDINGS AND OPTIONS AT FEBRUARY 28, 1963:

The parent company, Silver Buckle Mining Company is the holder of 585,714 shares 88.4% + 0 of the Company's issued and outstanding common stock. 285.714 shares were issued at par value in exchange for 1,999,998 shares 122.0% + 0 the parent company's common stock and 300,000 shares were issued for cash at par value. Additional shares may be purchased by the parent company for cash at par value as follows:

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED FEBRUARY 28, 1963

On or before	Number of shar
December 31, 1963	100,000
August 7, 1966	80,000
Total	180,000

All of the foregoing is pursuant to an agreement, under which the parent company acquired its interest, dated November 10, 1961.

Other stockholders of record as of August 7, 1961 have options to purchase common stock of the Company for cash at \$2.00 a share as follows:

Period	Number of shar	
September 30, 1962		
to September 30, 1963	111,600	
January 1, 1964		
to December 31, 1964	111,600	
March 31, 1965		
to August 7, 1966	55,800	
Total	279,000	

Options have been granted to key employees of the Company under terms of which 73,667 shares of the Company's common sock may be purchased for cash at \$2.00 a share. These options may be exercised at various times as earned and are conditioned upon continuing employment by the Company during the option periods. Employees of the Company have earned the right to purchase 32.667 of these shares.

Options to purchase common stock of the Company have been granted to others as follows:

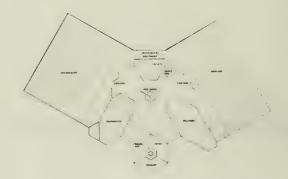
On or before

December	10.	1963	10.000	shares at \$2.00 pe
				share for cash
December	17,	1963	20,000	shares at \$2.00 pe
				share on conversio
				of a note payabl
				of \$40,000.00
December	17.	1963	20,000	shares at \$4.00 pe
				share for cash
December	10,	1964	10,000	shares at \$4.00 pe
				share for cash
December	10.	1964	10,000	shares at \$6.00 pe
				share for cash
			70,000	

None of the aforementioned options have been exercised.

ACCOUNTANTS REPORT

Note that the second of the se



THE INDOOR RECREATIONAL COMPLEX

National market studies point out the need for all types of indoor recreational equipment . . automated indoor archery centers, trapshoots, ice rinks, bowling, billiards and any kind of sport which is participant as opposed to spectator.

During the past ten years, participant sports have increased 116%. Spectator sports showed only a 60% gain during the same period.

Thus, on the horizon, there is a fast growing trend toward the concept of total indoor recreation.

One of the most interesting total concepts to date was designed by WCE associate, Designs For Recreation of Covina, California. The huge indoor recreational complex now under construction in Evansville, Indiana by MARC, Inc. (Mount Auburn

Recreation Center) controlled by John Engelbrecht and associates of Evansville, as shown above, is an example of this forward and aggressive type of planning.

Engelbrecht and associates plan to build at least five of the indoor recreational behemoths upon completion of the Evansville installation sometime this year.

Not shown is the second floor of the building. This space will be one of dual purpose. It will contain a regulation indoor ice rink that can be converted upon short notice to the "Top Of The Marc Ballroom" or convention hall. Included on the lower floor will be automated, indoor archery, automated, indoor trapshooting, bowling, billiards, and other popular indoor participant amusements and sports.



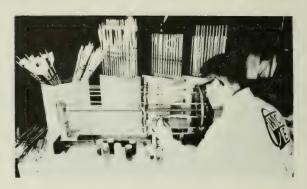


For the past year, the engineering department in conjunction with the manufacturing department, has been engaged in the development of the Trapomatic. A prototype of the unique indoor trapshoot was installed in the plant. The Trapomatic prototype was unveiled in early April with success to the Seattle press.

Along with daily testing of the new Trapomatic, the Archermatic is given continual test runs to substantiate its reliability. Modifying improvements and additions are being considered for the Archermatic by the engineering and manufacturing committees.

In what might be WCE's most significant development during 1963, the engineering department is developing a floor for installation in the myriad of indoor ice rinks that are being built all over the United States. The new design is a radical departure from the conventional ice rink floor. It is intended to cut installation and maintenance costs in new and existing indoor ice rink installations.

Other projects related to indoor recreation are also in the developmental stage or are being considered for development. However, because of the highly competitive nature of the recreation equipment industry, these will not be announced until such time as they become reality, patents are applied for and plans to market them are in effect.



MANUFACTURING

In pioneering a new industry such as automated, indoor archery, many new process and manufacturing procedures had to be developed. This development has taken place with no prior facts, figures or statistics from which to base efficient manufacturing performance or productivity.

At the present time, manufacturing is geared for rapid, efficient mass production of the Archermatic and Trapomatic automated equipment.

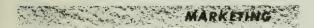
The manufacturing department with the aid of engineering, has developed several interesting processes which will have relationship to future profits of the company.

One procedure involves a large hydraulic press utilized in the manufacture of compressed corrugated cardboard mats used in every Archermatic target return in each of the installations. With many target frames in existence, a new mat has to be replaced about once every four to six weeks.

Manufacturing has also developed a new method of cresting arrows on a mass scale. Operational studies of the pro shops in the indoor archery centers have shown an excellent market for expensive, customized arrows, each of which is crested according to the individual's taste.

Several other interesting developments in the manufacturing department are presently taking place. However, the very nature of the competition in the indoor recreation industry precludes disclosure at this time.





The sale of an Archermatic or Trapomatic installation is not closed upon the signing of the equipment contract. WCE sales engineers' responsibilty with equipment purchasers includes site selection, securing of additional financing or investors, acting in an advisory capacity in the planning, architecture, contracting of each building or installation and seeing that the new business gets off to the proper start toward profits.

Closely allied with marketing is the WCE public relations and advertising program. The company's objective is to establish a broad program of national, regional and local publicity that will create a market for its products;

place institutional advertising on both regional and national levels to increase the consumer demand for archery and trapshooting and to provide complete, cooperative advertising and promotional programs for both existing and future indoor recreation centers with WCE equipment.

The sale of equipment (bows, arrows, related accessories) to indoor archerycenters by WCE is an important facet of its marketing activities. During the past year, sales of "pro shop" equipment have shown a steady, remarkable growth. Several other avenues of profit in this direction are being given attention at present in order to increase gross volume of sales and net profit.

OFFICERS AND DIRECTORS

BRYAN J. DICKINSON President

JACK D. GAY Executive Vice President

DR. F. E. SCOTT Secretary

NOLAN E. BROWN Treasurer

WILLARD J. DZIUK Director

BANKS

SEATTLE TRUST AND SAVINGS BANK . . Seattle, Washington

BANK OF CALIFORNIA, NA. Seattle, Washington

GENERAL OFFICE

WEST COAST ENGINEERING, INC. . . . 818 S. Dakota Street

Seattle 8, Washington

FIRST ANNUAL REPORT



WEST COAST ENGINEERING, INC.

NATIONAL STOCK SUMMARY October 1, 1962 to April 1; 1963

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Note: Oct 1951 receiver appointed.					
Assessment-1 cent per sh per s					
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Addt'l Issue-Apr 1054 1,000; Secs Corp. Harrison S Brethers					
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BILVER BUOKLE MINENC

COMPAN

WALLACE, IDAHC March 5, 1963

Nor. Den Marrison Penationa a Co. Pallo Central Building Spoking, Mushington

Dear Mr. Harrison:

As you may know, the Fecurities and Exchange Commission has been conducting in investment of transactions in the stock of Silver Euckle Manning Company occasing during the Fall of 1952. Tou, of coarse, have an interest in the nature of this investment.

The Securities and Director . Commission cannot, of course, also to the public the acture or the result of all investigations. As a recult of this lack of information, rumors have inaccurately reported the nature of this investigation and its connection with Silver Buckle Mining Company and its substanting.

Congress who he carries and discounce do amission is, as you know, charges by Congress who have any of real-maining surveillance over the exchange and over-the counter markets for securities. In the exercise of this duty the Commission is required to investigate unusual activity in these markets.

For a number of years the shares of Silver Buckle enjoyed a modest market, as a minimum of the business of West Coast Engineering in the archery field, substantial and wide-spread interest in the shares of Silver Buckle developed in the over-the-counter market. The price rose from about 20 cents per share in September to over \$\pm\$1.00 per share in December, an increase of \$500% in two months. It was only right and proper that the Securities & Exchange Commission should make an inquiry regarding trading in our shares during this period to assure itself such rise was not due to manipulative practices. Notifier, Silver Buckle nor West Coast Engineering did any trading in Silver Buckle shures.

The second area of the Commissioner's interests appears to concern a disjustion of Silver Buckle shares held by New Park Mining Company and East Utah Mining Company in September, 1962. In connection with an arrangement to

Mr. Ben Harrison March 5, 1963 Page 2

receive a disperse letween filter fleckle and those companies, a group of magnitude, included, contain officers and directors of the Company, a greed to parentse stock of fleckle then held by New Park and flast Utah. Some of these shared were subsequently sold by certain members of the group. The S. E. C. metting apparently has been directed to the question of whether the circumstances of their rates were such as to require registration under the Securities Act of 1900. The sollers, in making these sales, relied upon the advice of their counsel that rejistration was not required. We are advised, however, that the question of whether registration was required is close and technical.

1: 1954 Silver Buckle sold 1,000,000 shares of its common stock under Regulation A. Since then the Company has neither issued nor sold any additional shares which were subject to registration.

The Company has been advised by its counsel that neither the Securities Act of 1933 nor the Securities Exchange Act of 1934 impose any restrictions upon tracking in the presently outstanding shares of the Company except for certain restrictions with respect to controlling persons.

The inquiry described in the preceding paragraphs, relating as it does to transactions of stockholders, does not, in the opinion of our counsel, involve the operating activities or financing of the Gompany or its subsidiary.

The Company and its officers have cooperated fully with the Securities and Exchange Commission in their inquiry. If you desire any further information we would be pleased for you to contact us or our counsel, Mr. Alden Hull, Wallace, Teaho

Very truly yours,

SILVER BUCKLE MINING COMPANY

F.E. Scott, President

FESiimp

February 12, 1964

Mr. Harry Magnuson Scott Bullding Wallaza, Idoha

Door Honys

This latter is written to keep you and the other directors informed as to the progress and activities here at WCE.

We have directed our attempts to notify hir. Marbitz of the termination of the least on the equipment with him as of this data. We have previously given him notice of our intention to do so. We will thereafter by free to enter into a new least on the equipment. We are negotiating with a new group represented by John McMatarian in Downey. We have given him temperary rights to use the equipment, tent free, concelliable on a moment's notice, by wire or otherwise. You might be interested to know also ther we have retained legal service in Catifornia to curve our claim against him. Merbits.

The pretiminary papers have been crown and forwarded to Vinneti's attactives for them to look over in retarence to our deal with Vinneti. They have changed the deal shee I talked to them in California. They expert to be a little countous. The true time of money that will be located to very. If they go arranged with the crossent account consumer, will be \$25,000.00, and \$25,000.00 more in \$5 eays, and thereafter \$25,000.00 every shift days writh may reach a son of \$100,000.00. We have agreed to this, however, within the bady of this instrument, they have agreed to be intering a circular wavely we have a filtery day call notice, to that if we need money needly enturin, we can call for the rest of the money on a thirty day notice, or can concel them out on their convertible note program. I have this appears forwardle to yet and the text of the alreadors. We will issue those conventible notes on 05s interest on a two year basis from the time we reached the funds, and if VICE pays back the manay in two years, or they exercise their convertible rights, the Interest would be waived.

Farry, I called Guthrio day before yesterday to discuss the possibility of our changing our local program with Covina. I did this ofter discussing this quite themselved with our local staff, one they have advised me that we cannot make any outright changes in these locates with Outhwise approved. I was pressing this matter because time was becoming of estates of a reference to the Covina group reorganization and puriling new capital into their venture. Outhrie was samewhat non-committel, and vauld not make a commitment of all until his attenticy reforms from Howell matt week.

222 A

1 10 00 000

EMHIBIT NO. 1001

Mr. Herry Magnuson

-2-

February 12, 1954

It is my opinion that you and I should most with Cuthrio next week some time, and clieves the event situation, and endeavor to resolve with them some little of deal with the we can reorganize that a least on some type of program. As you well know, these principals will not put copital into the operations unless they are in a position and to be forcelosed on for lock of lone rental payments. And as I pointed out in our previous communications, I think it necessary that we do this, because for eight manifes or more new, they have not paid any rent whatesover, and their desire to try and work something out that will start the hell rolling is admirable on their point. I believe that in most cases, If I were in the position of these land operators, and thought I could get out from under these obligations, I personally would try and afide out how under them, because they have a big nut to brack in these high priced locations.

The program they have cuttined that they are going to endower to put. Into effect it to put it some pool and pin bolts, etc. I am guite happful that this will supplument that reparations to they can make ends moor. It is my proposal that we uncleaver to sell Guthris an a program where we put them an a minimum potentiage pay plan, and then we grouped it up to a point after they that making money, where we take down a large energy percentage, even though we would have to to to a consolice. The their volume will generatedly hereast to be point that we will get in many out of our engineers. If we do not do this, we stend a change of keying to remove the egistment from these bolletings, which I think would cost us at least 500.00 for remove the do so, and we have no place to go with it at the pursuantime. So, I this it would be according to take a good look of this thing, and my to sell Guthris on the pergram.

Again, I want to impress on you that logally, we have to have Guthria's per-along on this, because we could not adjust the payments on these leases any more than we could act to be permanted in the payment on someone class car Timened plan, its true in a we do not own the leases any more. However, we are responsible for than in a monitory way.

We have completed the order for Japan, and thelicald be completely borned and recely for allignant by rentite. We will stantisting temperature, and a sear to have the more changes at a the dock by filledy. This will get as in our planes with our or command with the Japanese people, and will turn the tenter of create into call with our original which will help as greatly those. As soon as this to dead, we will be in a value of professional profession accords for 12 more lenses, with a letter of create for a grants. Incl. \$25,000.00. We are also in communication with a serry in Aftergradge, New Morteo in II. I lense of our floor mosts, and we have a possibility of setting 20 times on the Foderal Way Shoosing Center.

All in all, with things looking up with Visnall and the mining struction tosking better, and a few orders beginning to trickle in, we are in a little better these new then we have been since t have been in with the company. I will keep you advised as to further progress.

Nr. Herry Megrusen

-3-

February 12, 1934

Lem receiving a number of letters from stockholders requesting information and reports on 1600 operations. I think it is going to become necessary to put our complete or report in the near fature, because they want to know why our stock is so low. Some stockholders are threatening to complete to the S.E.C. on this matterniates comment on this subject, because a report now would not be very flattering to WCE.

Best personal regards,

WEST COAST ENGINEERING, INC.

Glan W. Sharman

GWS:500

Golconda Mining Corporation SCOTT BUILDING P. O. BOX 468 WALLACE, IDAHO

SKYLINE 2-1131

February 15, 1964

Mr. Glen Sherman, President West Coast Engineering, Inc. 818 South Dakota Street Seattle 8, Washington

I wish to acknowledge receipt of your letters of February 12, 1964, reporting the progress of WCE. I am sorry to havemissed your telephone calls this week. I called back but was unable to make contact with you.

With respect to the Vindicator project, Dr. Scott and I have written Logus, Dr. Scott intends to meet with Logus this coming week and follow through on this. This, in our opinion, is the best way to handle this matter. We are doing everything possible to further the reorganization of Vindicator. I am pleased to note you have obtained Cary's legal advice to pursue our personal claim against Merbitz.

With respect to both the Downy and Covina installations, I would like to keep those leases in force and yet realize as much money as fast as we can for WCE. My only concern is we do not want to 'trigger" a termination of these leases which would result in Guthrie's calling upon Golconda for say \$150,000. if you can get Guthrie's cooperation, then I am in full accord with terminating thern and doing anything you deem best. I do not mean to infer Golconda is not prepared to meet its guarantee position. I think a premature large guarantee payment would have an adverse effect on WCE's interest.

In other words, if Golconda were forced to make a \$150,000 payment : : and time, we would have to take down a large amount of Silver Buckle Mines, nc. stock since there is no market value for it. I would prefer to keep the leases oing and to proceed as fast as we can towards the public offering of 1,000,000 or 1,500,000 shares of Silver Buckle Mines, Inc. capital stock by WCE, pursuant o Regulation A, at about 20 or 25 cents per share. This would then set the price t which Golconda could take down Silver Buckle stock at some future date in the event it was called upon to meet its guarantee commitments. The more I think I the public offering of Silver Buckle stock, the more convinced I am that this is he proper course of action. I think you understand fully my thinking on this natter and am hopeful that you and Dick Cary are in agreement on the public offering and we can proceed towards that end.

220 B

ENHIBIT NO. / 1977

Mr. Glen Sherman

-2-

February 15, 1964

With respect to the Vinnell agreement, I am happy that the papers have gone forth to them. While it would be more desirable to get all the money at this time. I think we can inform our creditors these payments are forthcoming and they will stand by. Also, it we proceed with the public effering of Silver Buckle Mines, Inc. capital stock, we should notify our creditors accordingly and I think this would be very agreeable with them.

With respect to Guthrie, I have the feeling you will find him very non-committal. I have written on several occasions and received no replies. I saw him last week inches was caractery retaily. I ran into him at the Devenport Hotel Coffee Shop. However, he is a "money dealer" and they are generally pretty cool when it involves their commodity. I think you should curtainly many Guthrie raily construction and as to your plane. I think you will have him very conference in it has always by a my thought that we should keep him advised and fully informed.

I am pleased to note that the installations are installing pool and pinball machines. This might generate sufficient money to at least provide some return each month with regard to the rent. I fully agree if you can sell the lanes to the Japanese for around \$4250 per lane, that i make the advisable to take these lanes from Covina and Denver, providing the cost of removing them and shipping them does not exceed \$500 per lane. This would certainly be a good way of cleaning up our contingent ladvistics in connection with Covina and Denver.

I fully agree with Mr. Cary we must get Guthrie's permission with respect to any revision of the lease. That is why I mentioned in my previous letter that any revision should probably be between WCE and the lessee with the understanding that WCE and/or Golconda would pick up the difference between the new revised rent and the rent per the original lease.

I am most pleased to note the shipment has been sent to the Japanese. I would like to see you obtain the order for the 12 additional lanes amounting to \$52,000 as soon as practical after making this initial shipment. This will enable us to liquidate a great deal of our inventory.

It is my the split that unless you can obtain the second order from the Japanese within a reasonable time that we should perhaps give further thought to our decision to terminate our archery manufacturing program and liquidate the equipment inventory and move to a low cost location. If this were done, our prime objective would be to complete the financing to enable us to pay off our creditors and salvage as much as possible for our stockholders. With the silver

February 15, 1964

Mr. Glen Sherman

market joint as it is and with the forthcoming crisis in silver which will be let up its grad by the shorth of at come, I am more and make convenient we modify the convenient and of Silver Sackle stock. I think we can find a modify make a period of the next is veril, making that we modify be an admirable may off all our creditors and still leave approximately 7 to a market silver of silver Backle stock to a silver be of the silver make the first which is a silver back sensewheres between 4 and 5 and of the first and for each large way.

If we can so that the animals of the second standard of the animals and a second of the second standard of the sec

With kind rejards, I in.

Very truly you ...

COLCUIDA MERNI COMPANY

By Dr. Thomason factor,

EF Mied

co: Richard Cary Alden Hull Juck D. Gay Alexander Juma Dr. F. E. Soutt

NOTICE OF SPECIAL MEETING SHAREHOLDERS OF WEST COAST ENGINEERING, INC. TO BE HELD MARCH 19, 1965

TO THE SHAREHOLDERS OF WEST COAST ENGINEERING, INC.:

NOTICE IS HEREBY GIVEN that a Revining of Shareholders of West Coast Engineering, Inc., a Washington Corporation, will be held at 10:00 A.M. (MST) on Friday, the 19th day of March, 1965 at the Elks Club, Wallace, Idaho, for the following purposes:

- To adopt, by resolution, the Plan of Liquidation and Dissolution, a copy of which is enclosed herewith.
- To consider and act upon all matters necessary or incidental to the foregoing proposal, and to transact such other business as may properly come before the meeting or any adjournment or adjournments thereof.

The Board of Directors has fixed the close of business on March 12, 1965 as the record date for the determination of shareholders entitled to notice of and to vote at said meeting or any adjournments thereof.

BY ORDER OF THE BOARD OF DIRECTORS
RICHARD S. CARY

DATED SEATTLE, WASHINGTON

The favorable vote of the holders of two-thirds of the outstanding shares of the Corporation is required to authorize the liquidation and dissolution of the Corporation. Accordingly if you are unable to attend the meeting, please sign and date the accompanying proxy and mail it promptly in the enclosed envelope.

TO: Shareholders of WEST COAST ENGINEERING, INC.

The last meeting of the shareholders of West Coast Engineering, Inc. was held on May 25, 1963. At that time a merger of the old Silver Buckle Mining Company and West Coast was authorized by the shareholders. One of the results of the merger was the formation of Silver Buckle Mines, Inc., a new company, to hold all the mining properties and mining assets, all the stock of which was owned by West Coast Engineering. This merger was accomplished to simplify and combine operations of the two companies and to facilitate new financing and banking arrangements for West Coast.

During the summer and early fall of 1963, floor model Archermatic equipment was developed, the first Trapomatic installation made and a new sales organization set up to handle the sales of Archermatics and Trapomatics. At the same time, working arrangements with national companies in the recreation field were being negotiated.

At the time it was believed that the commencement of the Fall indoor archery season would make a turning point for the archery installations since Denver, Portland, Covina and Downey had never had a full league season in operation. In October and November, 1963, however, it became apparent that (1) the business in the existing archematic installations was not picking up as it should have and (2) sufficient leagues were not being formed to provide a profitable picture for the operators. During the following six months, West Coast and the operators tried to increase the business in these installations. During this time many remedies were tried, including changes in management. Now, with the benefit of hindsight, it is apparent that these installations were operating with too high an overhead and were under-capitalized. These two handicaps could have been remedied and in many cases were, but the major reason for the failure and one for which there was no remedy was the lack of sufficient public acceptance of indoor archery. There simply were not enough customers who enjoyed the sport sufficiently over the long pull. The initial success these installations had was a result of a short-lived fad.

In the spring of 1964 it became apparent to West Coast, the various operators, the banks and financial houses and to West Coast's customers that archery as a recreational activity was not being accepted by the general public. The following resulted:

- All of West Coast's long range financing programs did not materialize and efforts to obtain new financing were unsuccessful.
- (2) The Burien, Portland and Covina installations closed their doors.
- (3) The Denver, Downey and Redwood City installations did not make their lease payments to the finance company, and could close at any time.
- (4) West Coast's backlog of orders was cancelled.
- (5) West Coast's large inventory of parts and completed and partially completed Archermatics became virtually valueless except as scrap metal, subject to a chattel mortgage.
- (6) West Coast's investments in patents, developmental costs and prototypes and other various promotional sales expenses became virtually valueless.
- (7) West Coast's accounts and contracts receivable from the operators have little if any value since the operators were insolvent.
- (8) The financial houses to which West Coast had sold the equipment leases under recourse

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agreements called on West Coast for about \$750,000 when the existing installations became delinquent in their rental payments.

(9) During this period West Coast borrowed \$55,000 from officers and directors, \$115,000 from its bank, and about \$180,000 was owed to general creditors. Obligations to finance companies exceeded \$1,000,000.

(10) A creditor filed a petition for the appointment of a receiver. (This suit was subsequently abated).

These debts totalled in excess of \$1,300,000 which had to be balanced against assets comported of an inventory of completed and partially completed Archermatics (for which there were no orders and no market) and accounts receivable from six existing installations in Burien, Denver, Portland, Covina, Downey and Redwood City, which past experience indicated could not be operated at a profit over the long pull. The remaining assets were the Idaho mining properties which were mortgaged to secure the debts and guarantys of West Coast. It appeared for a long time that West Coast's only alternative would be bankruptcy or receivership because the company was not able to meet its debts as they matured. If this had occurred, the entire company would have had to be liquidated for creditors, including the mining assets, and the shareholders would have been unable to salvage anything.

To avoid bankruptcy, it was apparent that a major reorganization had to be undertaken. To implement this, all employees were laid off, the plant shut down and arrangements were mode to phase out of the archery business as rapidly as possible.

In the meantime, the picture in the silver mining industry has changed drastically. The mining properties which are held by the new subsidiary company, Silver Buckle Mines, Inc., are now attracting a great deal of interest because of the increased world demand for silver. The company, therefore, believes that it is in the best interests of the shareholders to liquidate the archery venture, West Coast Engineering, Inc., and to take steps looking toward the development of the mining properties.

To this end, the officers and directors of West Coast have been working (without compensation) for more than a year to develop a plan of reorganization. The company has hired legal specialists in this field. As a result, we are pleased to report progress towards a successful reorganization out of court.

Certain stockholders have advanced their own cash for expenses and to pay general creditors on settlements ranging from 20% to approximately 33-1/3% of claims. Reimbursement will be in the form of Silver Buckle common stock at 15¢ per share for each dollar actually advanced. The three large unsecured creditors (\$75,000 - \$250,000), have been paid in full with Silver Buckle common stock at the rate of 20¢ per share. One secured claim of \$332,500 has been renegatiates so that the stock of Silver Buckle and the contract with Vindicator Silver Lead Mines, Inc., are now freed of encumbrances and the existing mortgage on Silver Buckle mining claims has been transferred to secure that creditor and the stockholders who have given personal guarantees to the secured creditor. That creditor and those guarantors have been given the right to convert the debt to Silver Buckle stock during the next three years at conversion rates ranging from 10 -15 cents per share. Accordingly, 3,350,000 shares of Silver Buckle stock are held in escrow in the event of conversion.

The directors believe that if the reorganization is completed as contemplated, about 2-1/2 shares to 3 shares of Buckle will be distributed for each share of West Coast. The remaining seven millian unregistered shares, authorized and issued, are held for investment and connot be resold except under restrictive conditions.

The notice of the meeting which is included herewith, sets forth the necessary steps to accomplish this reorganization and we unreservedly and strongly recommend this plan for adoption by the shareholders of West Coast.

If you do not plan to attend the stockholders meeting in person, please sign, date and return the enclosed proxy, NOW. This is crucial, since a favorable vote of two-thirds of the shareholders must be obtained in order to carry out the plan.

Silver Buckle Mines, Inc. owns many mining claims and mineral interests in Shoshone County, Idaho, including claims and interests in the Placer Center Mining District and the Hunter Mining District. These are 90 unpatented lode mining claims, mineral rights in property known as the "Brass Homestead," mineral leases from the Northern Pacific Railroad and the State of idaho, and a 50 per cent interest of the ore found under an operating and management agreement with Vindicator Silver Lead Mining Company. An existing map showing Silver Buckle's holdings pipears herein. While there is no assurance that the mining properties can be developed profitably, he development and discoveries in the area and the extent and location of Silver Buckle's claims and interests warrant further development.

The directors have been negotiating with several major companies and believe an exploration and development program for the mining properties can be worked out providing West Coast can put its financial house in order. The successful reorganization, payment of certain large creditors with common stock, liquidation of West Coast and distribution of the remaining Silver Buckle stock to the shareholders would accomplish this.

YOUR vote is essential for our successful reorganization.

WEST COAST ENGINEERING, INC.

DR. F.E. SCOTT

PLAN OF LIQUIDATION AND DISSOLUTION OF WEST COAST ENGINEERING, INC.

The plan of liquidation and dissolution of West Coast Engineering, Inc., a Washington Corporation, to be adopted by the shareholders of said corporation, shall contain the following provisions:

 The plan shall be carried out pursuant to the provisions of Section 337 of the Internal Revenue Code of 1954 and shall be completed within one year from the date of the adop-

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tion of the plan.

- The affairs of the corporation shall be wound up out of court and the shareholders do hereby appoint Gerard E. Schumm of the law firm of Miracle, Treadwell and Pruzan Seattle, Washington, as Trustee to conduct the winding up, all as provided in RCW Section 23.01.530.
- 3. The Trustee shall provide for the payment of debts of the corporation, by cash or by the issuance of common stack of Silver Buckle Mines, Inc., to certain creditors at a price per share of not less than 10¢ nor more than 20¢ per share. The Trustee is authorized to retain sufficent assets to provide for the payment of debts not liquidated in this manner or, in the alternative, the Trustee may accept the guarantee of certain shareholders of the corporation to provide for the payment of such debts.

 The Trustee shall transfer all of the remaining assets of the corporation not used for the liquidation of indebtedness in the above manner, to Silver Buckle Mines, Inc.

- 5. After provision has been made for the payment of the debts of the corporation, the Trustee shall distribute the remaining shares of stock of Silver Buckle Mines, Inc. pro rata to the shareholders of West Coast Engineering, Inc. In making such distribution to West Coast shareholders, the Trustee shall distribute only whole shares. Fractional shares shall be rounded to the next lower whole number of shares. Silver Buckle Mines, Inc. shall thereby become the surviving company and shall operate as a mining company.
- The Trustee shall thereafter proceed to wind up the affairs of the West Coast Engineering Inc., as provided in RCW Section 23.101.630.



COMPLED 160M EXELLABLE WAPS BOURCES MELLERED ALTHROUGH

ADDENDUM CONCERNING REORGANIZATION

It was thought that some stockholders would like to have, in advance of the meeting, more tails of the reorganization.

When the action for the appointment of a receiver was commenced the company hired attorys who specialize in corporate reorganization. They have directed the program of events which we culminated in settlements with creditors, reorganization of WCE by proposed dissolution, d the release of Silver Buckle stock for distribution to shareholders.

In order to accomplish the program outside cash was needed to settle claims and to pay administrative expenses. An estimated \$150,000 was needed initially, and a grazy of shareholders mposed of H.F. Magnuson, F.E. Scott, and Nolan and Robert Brown, responded and met the shipped of the shareholders were purchased through these shareholders for the benefit of the company at prices ranging from 20¢ to approximately 33 1/3¢ on the flar. These were settled on an individual basis after independent negotiation, with the majoresting for 20¢ on the dollar.

The Board of Directors of WCE met in November, 1964, and voted that shareholders who had ide previous loans to the company would be reimbursed with Silver Buckle Stock at the rate of a per share, if and when the stock was available for distribution. The new money advanced for addition settlements and expenses of administration would be reimbursed with Silver Buckle stock. The per share.

After settlement had been made with nearly all trade creditors there remained the problem of toining the revease of the shares of Silver Buckle stock from prevae to Golcono Mining of the control of the stock options, guaranteed a portion of WCE's debt to Guthrie restments, Inc., to the extent of \$420,000. As security for the guaranty, Golconda received a adge of all of the issued stock of Silver Buckle Mines, Inc., along with assignments and more ges on the various mining contracts and interests owned by Silver Buckle. At the time of regarization Guthrie Investments, Inc., was secured in the amount of \$332,560.00. The unsecured than of the debt. representing about \$200.00 (not was returned as a substitution of the debt. representing about \$200.00 (not was returned as some buckle stock, negotiations the Quthrie led to the release of Golcondo on its guaranty and the substitution of individual guarantees. The supersent of \$100.00 (not was settlements) and the Substitution of individual guarantees.

Mortgages on the Silver Buckle mining claims have been assigned and given to Guthrie and parantors as security. The advantages to shareholders are: Guthrie did not call on Golcondo pay the guarantee, which meant that Golcondo did not foreclose on its security; the Silver ckle stock was released from pledge and is available for distribution to WCE shareholders; the ver Buckle-Vindicator contract has been released from assignment; the debt is now extended to these verbages.

or three years.

Under this agreement Guthrie Investments, inc. and the guarantors have the option over three gars of receiving Silver Buckle speck in lieu of payments at prices ranging from 10¢ to 15¢ per are, depending on when the option is exercised. The options are given in proportion to the count of the debt that is guaranteed, each individual having a option up to the amount he has transfer.

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A maximum at 1,20,0 s of stock is being held in escrow should all these options be exercised. If all the option are the cised the debt will be discharged and the mortgages satisfied. All parties who have received Silver Buckle stock, either in satisfaction of creditor claim or as stockholders being reimbursed for monies advanced, have agreed to take the stock for it.

vestment and with no present intention of resale. Under agreement with Guthrie, Silver Buckl-Mines, Inc. is obligated to undertake a full registration of stock if Guthrie should make a demo on the company to do so. If a registration is completed a portion of or all of the stock held b such creditors and spaceholders could be offered for sale as part of such public offering

There are twelve million shares of Silver Buckle Mines, Inc. stock. Approximately 5 millio to 5 1/2 million shares should be available for distribution, and the company expects to distribut 2 1/2 to 3 shares of Silver Buckle stock for each share of WCE stock. The remaining 6 1, 2 mi lion to 7 million shares of stock are needed for settlement with creditors, reimbursement of share holders, and expenses of administration. This is broken down as follows: Lease Equipment, Inc 375,000 shares (in settlement of unsecured debt of \$75,000.00); The Bank of California, N.A. 622,781 shares pledged (in settlement of unsecured debt of \$124,556.00 - - - Glen W. Sherman has option to redeemup to 100,000 shares within one year); Guthrie Investments, Inc., 1 million shares (in settlement of unsecured debt of \$200,000 net); 3,350,000 shares are held in escrow to cover the options granted to Guthrie and Guarantors relating to the secured portion of the deb to Guthrie Investments, Inc.; 25,000 shares to H.F. Magnuson for a previous loan of \$5,000.00 100,000 shares to Dr. F.E. Scott or a previous loan of \$20,000.00; and approximately 1 million to 1 1/2 million shares will be needed for reimbursement to shareholders at 15¢ and 20¢ per share for the actual money advanced for settlement with trade creditors and for expenses of adminis tration, legal and accounting fees, printing, mailing and operating expenses. A majority of this stock will go to H.F. Magnuson, as he has advanced the great majority of funds needed to perfect the reorganization.

The information contained herein is provided so that you may better understand the reorganization and its benefits to shareholders. Your vote in person or by proxy is needed to complete the reorganization.

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(Securities Exchange Act Release No. 8063)

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.
April 27, 1967

In the Matter of

PENNALUNA & COMPANY, INC. Radio Central Building Spokane, Washington

and

BENJAMIN A. HARRISON HARRY F. MAGNUSON

File No. 8-11752

Securities Exchange Act of 1934 -Sections 15(b) and 19(a)(3) FINDINGS AND OPINION OF THE COMMISSION

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BROKER-DEALER PROCEEDINGS

Offer, Sale and Delivery of Unregistered Securities

Manipulation of Market

Misrepresentations in Sale of Securities

Bids for and Purchases of Stock While Engaged in Distribution

Improper Extension of Credit

Failure to Mark Sell Orders "Long" or "Short"

Failure to Disclose Common Control

Failure to Comply with Records Requirements

Where predecessor firm of registered broker-dealer and its two partners, who subsequently became sole owners of registrant, distributed large blocks of unregistered "control" shares, manipulated market in securities, made misrepresentations in sale of securities, bid for and purchased securities during distributions and failed to comply with other applicable requirements, held, in public interest to revoke broker-dealer's registration, bar principals from association with any broker-dealer, and expel one of principals from national securities exchange.

Where partner of registered broker-dealer, who acted as firm's trader, made false and misleading statements and unwarranted predictions of price increases to trader for another securities dealer, and partner purported to have and was looked to as source of specific information regarding issuer's condition and prospects, held, statements and predictions were not merely permissible "chatter" between traders and violated anti-fraud provisions of securities acts.

4609

Where a director and controlling person of issuer of securities sold such securities without disclosure of adverse financial condition of issuer inconsistent with favorable image of issuer known to and fostered by him, held, sales violated anti-fraud provisions of securities acts.

PPEARANCES:

Thomas W. Rae, and James E. Newton, Lane B. Emory and John N. eqan, of the Seattle Regional Office of the Commission, for the Division f Trading and Markets.

James C. Sargent, of Lowenstein, Pitcher, Hotchkiss & Parr, for ennaluna & Company, Inc.

Horton Herman, of Paine, Lowe, Coffin, Herman & O'Kelly, for enjamin A. Harrison.

Woolvin Patten, of LeSourd & Patten, for Harry P. Magnuson.

These were private proceedings pursuant to Sections 15(b) and 9(a) (3) of the Securities Exchange Act of 1934 ("Exchange Act") to deemine whether we should take remedial action with respect to Pennaluna Company, Inc. ("registrant"), Benjamin A. Harrison and Harry F. agnuson. Solely for the purpose of these proceedings and any other adinistrative proceedings under Sections 15(b), 15A and 19(a) (3) of the xchange Act and Section 203 of the Investment Advisers Act of 1940, espondents entered into a stipulation of facts with our Division of rading and Markets ("Division") and waived a hearing. Briefs were filed nd we heard oral argument. Our findings are based on an independent eview of the record.

Registrant registered as a broker and dealer in November 1963 as uccessor to the partnership of Pennaluna & Company ("Pennaluna") which ad become registered in 1954. Harrison and Magnuson were the sole artners of Pennaluna after 1961 with interests of 62½% and 37½%, respecively, and became registrant's sole stockholders, with the same proportionate interests, and its principal officers. Harrison, a member of he Spokane Stock Exchange, operated the firm's Spokane office and was n charge of the trading activities of the firm. Magnuson was responsible for the supervision of the firm's two offices in Idaho and for the aintenance of its records.

The principal allegations in the order for proceedings are that luring the period between May 1962 and April 1964 respondents and Mennaluna willfully violated the registration and anti-fraud provisions of the Exchange Act of 1933 ("Securities Act") and the anti-fraud provisions of the Exchange Act in connection with the sale of common stock of Silver Buckle Mining Company ("Silver Buckle") and West Coast mighineering, Inc. ("West Coast"). Silver Buckle had been incorporated in 1947 by Dr. Frank E. Scott and others, and prior to November 1961 laded association with West Coast, which was engaged in the manufacture and distribution of equipment for automated archery lanes. As of May 1962, Silver Buckle had obtained control of West Coast through the acquisition of newly issued shares in exchange for about 2,000,000 shares of Silver Buckle stock and cash, and in June 1963 Silver Buckle was merged into West Coast.

Violations of Registration Provisions

The Division urges that Pennaluna, Magnuson and Harrison willfully violated Section 5 of the Securities Act in connection with the distribution through Pennaluna of two blocks of Silver Buckle stock and certain West Coast shares, and that Magnuson committed additional violations of that Section in sales of such securities to others than Pennaluna.

The first block of Silver Buckle stock in question consisted of part of a block that had been held by Oil Incorporated ("Oil, Inc."). As of early May 1962 and prior to its exchange of stock with West Coast, Silver Buckle had approximately 7.4 million shares outstanding, of which a total of about 1.8 million were owned by Oil, Inc., New Park Mining Company ("New Park") and East Utah Mining Company ("East Utah"), in approximately equal proportions. A total of about 1 million additional shares was owned by Scott, president and a director of Silver Buckle, another director of Silver Buckle, and Jack D. Gay, an associate of Scott, who was executive vice-president and a director of West Coast.

During early 1962, W. H. Crammer, the controlling person of the above three companies. Was in the process of turning over the management of Oil, Inc. to his son, and was ousted from the management of New Park and East Utah by Charles A. Steen. Scott was desirous of preventing Steen from acquiring control of Oil, Inc. and the 600,555 shares of Silver Buckle stock which it owned, and in May 1962 he arranged with Crammer's son, then president of Oil, Inc., to sell those shares to Scott at 10¢ per share. Scott did not have the funds to acquire all the shares, and he induced Magnuson to acquire part. Magnuson and accounts for his children of which he was custodian bought 172,000 shares Pennaluna 90,555 shares, and Scott 14,000 shares, and Magnuson and Scott late 90,555 shares to retail customers and other broker-dealers within two months. Magnuson resold his 172,000 shares to persons and dealers other than Pennaluna over a period of about one year.

The second block of Silver Buckle stock under consideration consisted of part of a block that had been held by New Park and East Utah. In August 1962, Steen informed Scott that he was going to have him removed as president of Silver Buckle, and a suit against Silver Buckle was brought by New Park and East Utah because they had been denied access to Silver Buckle's records. Thereafter, Steen caused New Park and East Utah to start selling their holdings of Silver Buckle stock. Scott was concerned that such sales would depress the price of the stock, and, with the assistance of Magnuson, reached an agreement with Steen on September 29, 1962, for the transfer of that stock. Pursuant to such agreement, New Park and East Utah transferred to Silver Buckle 367,111 of its shares and undertook to sell Magnuson their remaining 800,000 shares at 20¢ per share. Scott agreed to take 300,000 of such shares and Pennaluna 200,000. Magnuson acquired 300,000 of the shares for himself; Pennaluna paid for 100,000 shares in October 1962 and resold them to retail customers and other dealers during the following

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two months and took down its second 100,000 shares in November 1962 and January 1963; and Scott eventually acquired for himself and others 220,000 of the shares. 1/

In January 1963 members of our staff discussed with Magnuson whether the Silver Buckle stock acquired by him and Pennaluna from New Park and East Utah was control stock which could not be sold without registration under the Securities Act. Pennaluna thereupon earmarked the second 100,000 shares and charged the payment it had made for them to the drawing accounts of Harrison and Magnuson, in proportion to their interests in the firm. However, in a series of transactions from 12 through June 18, 1963, Pennaluna, without contacting our staff, repurchased these shares from Harrison and Magnuson, through the account of Jerry T. O'Brien, a cousin of Harrison, at prices ranging from 55¢ to 61¢ per share and resold them to retail customers and other dealers (the "O'Brien transactions"). Moreover, between May 1962 and June 1963 Magnuson for his own account and as custodian for his children sold about 238,500 shares of Silver Buckle to broker-dealers other than Pennaluna. At least some of these shares were resold to public investors.

Beginning in late 1962, Magnuson became deeply involved in the affairs of West Coast, directly and through Golconda Mining Corporation ("Golconda") of which he was a controlling person. West Coast, which for some time had represented by far the most important asset of Silver Buckle, became increasingly dependent on Magnuson's guidance and help as its financial problems became more acute. Pursuant to Magnuson's initiative in November 1962, Golconda guaranteed, up to \$420,000, West Coast's recourse obligations on its sale in January 1963 of certain archery equipment leased to archery ranges. For such assistance Golconda received options to purchase West Coast stock and as security West Coast pledged its approximately 2 million shares of Silver Buckle tock and Silver Buckle gave Golconda a first lien on its mining properties and pledged its mining securities. Magnuson and Golconda also made several loans to West Coast and purchased West Coast stock, and Magnuson played an active role in West Coast's efforts to obtain additional funds. In the spring of 1963, he participated in effecting a merger of Silver Buckle into West Coast and the organization of a new corporation which took over Silver Buckle assets and pledged all of its stock to Golconda in place of the Silver Buckle stock.
Magnuson became a director of West Coast in May 1963 and thereafter of the merged company, and was instrumental in having two others elected as directors and in having one of them elected president.

The West Coast shares claimed to have been sold in violation of Section 5 were part of a block of 43,750 shares 2/

^{1/} Of the balance of the 800,000 shares, 70,000 were later purchased by Magnuson and his mother and 10,000 by his attorney.

^{2/} The number of shares reflects the subsequent conversion, in connection with the merger of Silver Buckle into West Coast, of each share of West Coast \$2\$ par value stock into \$2\$ shares of no par stock.

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purchased in December 1962 from the issuer by Magnuson individually and as custodian for his children. In September 1963, he sold 5,250 of those sheres to Pennaluna, which resold 750 shares.

No registration statement with respect to Silver Buckle or West Coast stock had been filed or was in effect during the period under consideration. The Division contends that Pennaluna acquired the stock in question from Magnuson; that Magnuson was a member of the group in control of Silver Buckle and later West Coast; and that Pennaluna was therefore an underwriter and its sales of those shares were not exempt, as respondents claim, from the registration provisions of the securities Act by virtue of Section 4(1) of that Act. 3/ It directs particular attention to what it characterizes as "bail-outs" by Harrison and Magnuson in their sales of Silver Buckle stock through the O'Brien account. The Division further urges that even were Pennaluna's purchase of the 90,555 shares in May 1962 to be viewed as having been made directly from Oil, Inc., that company was a member of Silver Buckle's control group at the time and Pennaluna was therefore an underwriter.

Respondents argue that Pennaluna did not purchase the Silver Buckle shares from Magnuson, but from Oil, Inc., New Park and East Utah; that, in either event, neither those companies nor Magnuson were in control of Silver Buckle; and that Pennaluna's resales of those shares were therefore exempt under Section 4(1) of the Securities Act. As to the O'Brien transactions, respondents assert that Magnuson's counsel had advised him that New Park and East Utah were not controlling persons, and that the sales effected through O'Brien were made for tax purposes without any effort at concealment. Respondents contend that Pennaluna's sale of the 750 shares of West Coast was exempt since those shares had been held by Magnuson for some eight months following their purchase from the issuer in December 1962.

It appears that throughout the period when Silver Buckle's stock was being distributed, as described above, Magnuson and Scott were in effective control of Silver Buckle and by various arrangements and with the assistance of Harrison and the younger Cranmer were able to arrange for the acquisition of large blocks of Silver Buckle stock by friendly hands or for its disposition to new owners who would not pose the threat to the market indicated by Steen. Magnuson as a member of a control group in Silver Buckle, if not himself actually in control, caused accounts over which he had discretionary authority or otherwise controlled and the facilities of Pennaluna to be employed to buy and resell to the public large amounts of Silver Buckle stock. Pennaluna thus sold for or on behalf of a controlling person of the issuer or, in the case

^{3/} Section 4(1) of the Securities Act exempts from the provisions of Section 5 transactions by any person other than an issuer, underwriter or dealer, and Section 4(3) exempts dealers! transactions where no distribution by an issuer or underwriter is involved. The term "underwriter" is defined in Section 2(11) of the Act as including any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security or participates or has a direct or indirect participation in any such undertaking. For purposes of Section 2(11), "issuer" is defined as including a person directly or indirectly controlling the issuer or under common control with the issuer.

of the O'Brien transactions, purchased from an "issuer" with a view to distribution, and therefore became an "underwriter" within the meaning of section 2(11) of the Securities Act. Its sales of the unregistered Silver Buckle stock therefore violated the provisions of Section 5 of that Act, and Magnuson participated in such violations. 4/ Similarly those sales by Magnuson of such shares to broker-dealers other than beennaluna which were resold by them to the public were in violation of that Section. Moreover, Pennaluna was an underwriter with respect to the West Coast shares which it purchased from Magnuson and resold. It is no defense that Magnuson had held these shares for several months, since even aside from whether such an interval would be significant were Magnuson not a controlling person, he was an "issuer" for purposes of determining Pennaluna's status as an underwriter within the meaning of Section 2(11) as a result of his controlling position.

Harrison, who, as the firm's trader, effected the sales to oroker-dealers and to retail customers for Pennaluna, was aware of cats which put him on notice that distributions of control stock might be involved. He knew that Magnuson had twice purchased large blocks of silver Buckle stock for Pennaluna and that in January 1963 our staff had caised questions regarding the legality of sales of the stock emanating from New Park and East Utah. 5/ At least by April 1963, he was aware of the fact that Magnuson was taking an active part in West Coast's iffairs, and by the time Pennaluna purchased the West Coast shares from Magnuson, Harrison knew that Magnuson was a director of West Coast.

Accordingly, we find that Pennaluna, Magnuson and Harrison willfully violated Sections 5(a) and 5(c) of the Securities Act.

Miolations of Anti-Fraud Provisions

Manipulation of Market; Misrepresentations in Sale of Securities

The order for proceedings alleges, among other things, that beginning about September 29, 1962, Harrison and Magnuson caused Pennaluna to engage in manipulative activities with respect to Silver Buckle stock designed to raise the price of such stock artificially and to induce

- We do not agree with respondents argument that where unregistered shares emanate from a person allegedly in control of the issuing company rather than from the company itself, the claimant of an exemption from Section 5 of the Securities Act does not have the burden of proof. That Section imposes a broad prohibition against sales of unregistered securities and the principle is well recognized that one claiming exemption has the burden of establishing it. See S.E.C. v. Ralston Purina Company, 347 U.S. 119 (1953); S.E.C. v. Culpepper, 270 F. 2d 241, 246 (C.A. 2, 1959); Securities Act Release No. 4445 (February 2, 1962).
- 5/ Although respondents claim they relied on the advice of counsel that there were no restrictions on trading by Magnuson and Pennaluna of the shares acquired from New Park and East Utah, counsel's advice failed to give consideration to the influence resulting from Magnuson's participation with Scott in the Oil, Inc. and New Park - East Utah transactions.

other broker-dealers to bid for such stock. In addition, it charges that in the offer and sale of Silver Buckle and West Coast stock Harrison and Magnuson made and caused Pennaluna to make false and misleading statements and omissions of material facts.

During the period under consideration, the dealers in Spokane, including Pennaluna, listed their inter-dealer bid and asked prices with respect to local mining issues, including Silver Buckle, in quotation sheets (the "Spokane sheets") that were used to make a composite quotation sheet distributed to the news media. During September 1962, the bid quotations in the Spokane sheets for Silver Buckle stock were in the range of 15¢ to 17½c. Pennaluna, which submitted quotations on 16 days, was high bidder on only two days, and was high together with other firms on only four other days. During the course of the month, it purchased only 1,000 shares of Silver Buckle stock on the open market, and sold a total of only 15,000 shares. Its last quotations for the month were 16¢ bid, 20¢ offered on September 27, and as of the end of the month it had a long position of about 13,000 shares. However, following Pennaluna's agreement on September 29, 1962 to purchase 200,000 shares at 20¢ per share, the firm's trading volume in Silver Buckle stock took a dramatic upsurge and the quotations showed a steady increase in which Pennaluna was the consistent leader.

On October 1, Pennaluna, notwithstanding its acquisition of the large block two days earlier at 20¢ per share, raised its quotations to 22¢ bid - 25¢ asked, its bid being 3¢ higher than the next highest. On that day, it bought 11,500 shares from other dealers at prices of from 18½ to 23¢ and sold 17,300 shares to retail customers at 20 to 25¢. From that point on, the bid quotations rose almost steadily to a high of \$1.40 on January B, 1963. During this period, Pennaluna submitted quotations on all but two trading days. Out of 56 days on which Pennaluna and at least one other firm submitted bids, Pennaluna was the high bidder on 34, and on 13 days its bid was equal to the high. On 7 additional days, Pennaluna was the only bidder. Although there was a substantial number of dealers in various parts of the country who made a market in Silver Buckle stock, the record shows that at least for the period from October 1 through December 4, 1962, Pennaluna did by far the greatest volume of trading in such stock.

Respondents contend that the increased activity in and price of Silver Buckle stock were due to investor demand following publicity regarding West Coast's archery installations, one of which was opened on September 28 or 29, 1962 and three others later that year. However, while the publicity undoubtedly served to stimulate demand for Silver Buckle stock, in our opinion Pennaluna's activities contributed substantially to the increase in trading and rise in price. Pennaluna's bidding and trading in the stock and its obvious motive for raising the price level, coupled with misrepresentations by Harrison to other dealers relating to the Silver Buckle stock and bullish predictions as to its future market price discussed below, make it clear that Pennaluna and Harrison engaged in a manipulative scheme in the sale of that stock. 6/

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^{6/} Cf. Bruns, Nordeman & Company, 40 S.E.C. 652, 660, n. 11 (1961), where we pointed out that "a person contemplating or making a distribution has an obvious incentive to artificially influence the market price of the securities in order to facilitate the distribution or to increase its profitability. We have accordingly held that where a person who has a substantial interest in the success of a distribution takes active steps to increase the price of the security, a prima facie case of manipulative purpose exists. The Federal Corporation, 25 S.E.C. 227, 230 (1947). See also Halsey Stuart & Co., Inc., 30 S.E.C. 106, 124 (1950)."

The misrepresentations and predictions were made in a series of teletype conversations beginning on October 2, 1962. 7/ In teletypes to J. May & Co. ("May"), a New York broker-dealer with which Pennaluna had a substantial number of transactions and which also made a market in Silver Buckle stock during the period under consideration, Harrison advised that an agreement had been reached for the disposition of Steen's holdings of Silver Buckle stock so that none of the New Park - East Utah blocks would thereafter be available and that "Silver Buckle will be the big one out here and all over the country soon. It's 23-25 and will be 65 one of these days, so don't get caught on it." B/ When May inquired if it should "go long," Harrison responded, "!'ll quarantee it. Don't want market up right now. Certein deals being eigned between company and Steen, etc., but it will take off. It's terrific deal... orders coming in for that archery stuff from all over world," 9/ and later that month he told May the stock was "headed for 1." Harrison wired a Seattle dealer that the price of Silver Buckle stock would rise and there would be "some very good inside buying on it." To another dealer he wired in November, "The big deal here is Silver Buckle. It is going to sell much higher. Archery business deal taking over like wild fire." In December, Harrison advised May in response to the latter's inquiry that the Silver Buckle shares transferred in the New Park - East Utah transaction other than those reacquired by Silver Buckle had been bought by Scott and others, and were not for sale and were "off the market." In a February 1963 teletype, Harrison replied in the affirmative to a question by May as to whether West Coast showed a monthly profit, adding that the situation was "getting better every day - every time they open up one [of] those deals it's like making a new rich strike in a mine."

Respondents assert that Harrison's predictions of price increases were based on his "feel of the market" and point to the stipulated fact that his prediction to May of a 65¢ price was based on his experience as a trader, what he knew about Silver Buckle and what he had heard about West Coast. $\underline{10}/$ They contend that price predictions to other

- The fact that, as noted by respondents, most of Pennaluna's teletype conversations were originated by other dealers does not affect our conclusions. If anything, it highlights the fact that Pennaluna was viewed by other dealers as a leading, or the leading, marketmaker in Silver Buckle stock.
 - The punctuation in this and other quoted teletype messages is our own. The messages themselves contain no punctuation.
- If is stipulated that the rise in the price of Silver Buckle stock between September 28 and October 1 caused embarrassment to the officials of New Park and East Utah and that Magnuson thought they might refuse to complete the sale of Silver Buckle stock. Harrison's statement appears to reflect both control of the market and artificial influences brought to bear upon it. Another statement indicative of manipulative conduct was made by Harrison on October 19, after the quotations had temporarily gone down, when, in response to May & Co.'s inquiry, "what is making Silver Buckle easier?". he replied "Salt Lake wants a low quote on it to justify their sale to Silver Buckle Company so accommodating them won't last long, couple days is all . . ."
- 10/ Harrison testified that he based his prediction on "more or less rumors" which he heard from other brokers.

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broker-dealers and to sophisticated investors are recognized as being merely expressions of opinion and are not improper. Respondents also assert that Pennaluna and May were arbitrage dealers interested primarily in the quotations of other dealers, 11/ and that Harrison's teletype conversations with May's trader were merely "chatter" between traders on which the latter did not rely. We cannot accept these defenses.

We recognize that it is common for traders to exchange views regarding the present and probable future state of the market in a security and that, as noted in the Report of the Special Study of Securities Markets, 12/ many firms make markets on the basis of activity in a security rather than on information concerning the issuer's financial condition. It is equally clear, however, that representations and price predictions made by one dealer to another, including those made by one trader to another, may if false or misleading violate the anti-fraud provisions of the federal securities laws just as those made to a customer, 13/ whether couched in terms of opinion or fact, 14/ and whether or not reliance is placed upon them. 15/ Harrison falsely represented to May that the shares from the New Park - East Utah transaction were not for sale and that West Coast was operating at a profit and its situation was improving. As to the latter, West Coast had in fact sustained a net loss of \$203,063 for the nine months ended September 30, 1962, and had a cumulative deficit of \$276,835 as of that date which had increased to \$413,567 by the end of the year. In January 1963 West Coast sold for \$770,000 its equipment leases for the four archery ranges opened in late 1962, which created a contingent liability by West Coast and Silver Buckle of about \$851,000 for any rent defaults. At the time of that sale, one of the lesses was already in default on its rental payments. For the year ended February 28, 1963, during which it had sold the leases with respect to all five ranges then in existence, West Coast sustained a net loss of \$59,376 and as of that date had a deficit of \$167,477.

Moreover, it is clear that the other dealers placed reliance upon Harrison's statements. The teletypes show that he purported to have and was looked to as a source of specific information regarding the condition and prospects of Silver Buckle. Under the circumstances the conversations cannot be characterized as mere "chatter." Although May's trader stated that he never relied on information or opinions conveyed by Harrison other than quotations, he subsequently testified

^{11/} Arbitrage dealers seek to take advantage of price differentials including differentials which may arise where the same security is traded in different markets. See Report of Special Study of Securities Markets (H. Doc. No. 95, 88th Cong., 1st Sess.) Pt. 2, p. 250 (1963).

^{12/} H. Doc. No. 95, Pt. 2, 88th Cong., 1st Sess., p. 563 (1963).

^{13/} See Van Alstyne Noel & Company, 33 S.E.C. 311 (1952); Gearhart & Otis, Inc., Securities Exchange Act Release No. 7329, p. 23 (June 2, 1964), aff'a 348 F. 2d 798 (C.A.D.C., 1965).

^{14/} Cf. Mac Robbins & Co., Inc., 41 S.E.C. 116, 119 (1962), aff'd sub nom. Berko v. S.E.C., 310 F.2d 137 (C.A. 2, 1963).

^{15/} Cf. N. Sims Organ & Co., Inc., 40 S.E.C. 573, 575 (1961), aff'd 293 F. 2d 78 (C.A. 2, 1961), cert. denied 368 U.S. 968.

that he did rely on Harrison's statement that the New Park — East Utah holdings of Silver Buckle were "off the market" and "not for sale," and that if this large amount of Silver Buckle stock were "floating around," he would want to "get away" from that security. This only confirms what is apparent from the conversation itself.

With respect to Magnuson, although he did not himself engage in the above trading activities or teletype conversations, he must also be found to have participated in the manipulative and fraudulent conduct described. He knew or should have been aware of Pennaluna's increased trading volume in Silver Buckle stock, the firm's increasing bids, the steadily rising price levels, and the incentive for raising the market price which existed by virtue of Pennaluna's ownership of 200,000 shares, an unusually large amount for Pennaluna to acquire at one time. Under these circumstances and by virtue of his position as a partner in Pennaluna and his substantial participation in the profits from the firm's trading in the stock of Silver Buckle as to which he was the partner most directly interested, Magnuson had a duty to keep himself apprised and provide appropriate restraints as to the manner in which such trading was being conducted. 16/ As an active major partner he had a duty to know of the nature and scope of the firm's activities, and being chargeable with knowledge, he must be held to have at least a shared responsibility for the violations which occurred.

Moreover, Magnuson himself sold large amounts of West Coast stock to Pennaluna and others during the period beginning in August 1963 and extending through December 1963 without disclosing the adverse financial condition of West Coast. 17/ According to Magnuson, he realized in early May 1963 that matters were not going well at West Coast and that its management was incompetent. Toward the end of that month the management of West Coast was reorganized and Magnuson elected a director. In June he received financial statements as of May 31, which showed a cumulative deficit of \$334,657 and a loss of \$37,521 for the preceding month and was again told that West Coast faced a pressing financial condition. 18/ in the following two months West Coast was informed that two of the archery ranges had lost about \$88,000 during the first half of the year and that another was seriously in debt and might have to discontinue operations. The fourth range had already been taken over by West Coast at the end of May and the lease purchaser

^{16/} Cf. Alfred Miller, Securities Exchange Act Release No. 8012 (December 28, 1966), p. 6; Thompson & Sloan, Inc., 40 S.E.C. 451, 457 (1961); John T. Pollard & Co., Inc., 38 S.E.C. 594, 598 (1958).

^{17/} From August through December 1963, Magnuson sold 29,351 shares of West Coast stock for his own account and as custodian for his children, mostly to broker-dealers other than Pennaluna.

^{18/} West Coast's president told Magnuson that the company's cash requirements through October for production of archery equipment and payment of "old accounts payable" were estimated to exceed \$300,000 and that no further installations were anticipated during that time. West Coast's balance sheet as of June 30, 1963 showed total cash of only \$33,836.

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had threatened to terminate the leases which would subject Vest Coast to claims on its recourse obligation. Further loans from Magnuson and Golconda and the sale in October of the lease of equipment for an additional range only delayed the eventual collapse of the archery enterprise.

It is contended that the seriousness of West Coast's problems was not appreciated until September 1963 and that a cash flow projection prepared about February 1963 envisaged an improvement in cash flow after May 1963. Respondents point out that the change in West Coast's management in May 1963 was expected to remedy former financial and operational problems. However, there was little tangible basis for optimism during the first half of 1963 in view of West Coast's losses during that period and its financial stringency. Moreover, by the middle of August, when Magnuson began to sell his holdings of West Coast stock, there could be no question as to the desperate circumstances of West Coast. The projected cash flow, which was based on leases and sales of additional equipment, had not materialized, the deficit had continued to grow, and the hoped-for financing had not been obtained.

As a director and controlling person of West Coast Magnuson was an insider and as such, under principles now well established under the anti-fraud provisions, was under a duty in his securities transactions to disclose material information known to him by virtue of his position. $19/\ \mathrm{At}$ least by August 1963 a situation existed which clearly gave rise to a duty of disclosure by Magnuson when he effected sales of his West Coast stock. $20/\ \mathrm{Magnuson}$

Magnuson knew that although West Coast was a new and untried business, an image of a highly promising enterprise had been created, and he himself contributed to furthering that image. West Coast's annual report as of February 1963 contained statements by the company's president that a healthy growth had been experienced, substantial orders were on hand and additional archery installations were to be made, and those statements were published in various newspaper articles in the spring of 1963. A consistently favorable picture was also presented, as late as the middle of September, in "Mining Hi Lites," a weekly information sheet published under the sponsorship of a group of Spokane dealers, including Pennaluna, which was distributed to dealers and republished in newspapers in Idaho and Colorado. Pennaluna mailed about 50 to 80 copies to securities firms in various parts of the United States and a number of individuals including Magnuson. In early July 1963, Magnuson was in contact with the publisher of a financial news letter and sent him a copy of West Coast's February 1963 annual report. The August 15 edition of the newsletter was devoted to West Coast, was headed "pioneer and Leader in Rapidly Growing Field of Automated Indoor Archery, with Promising Silver Mining Prospects," and painted a glowing picture of operations and future prospects. This

^{19/} See List v. Fashion Park, Inc., 340 F. 2d 457, 461-62 (C.A. 2), cert. denied 382 U.S. 811 (1965); S.E.C. v. Texas Gulf Sulphur Co., 258 F. Supp. 262 (S.D. N.Y., 1966), app. pending: Speed v. Transamerica Corp., 99 F. Supp. 808, 828-829 (D. Del., 1951); Kardon v. National Sypsum Co., 73 F. Supp. 798, 800 (E.D. Pa., 1947); Cady, Roberts & Co., 40 S.E.C. 907 (1961).

^{20/} As we pointed out in <u>Cady</u>, <u>Roberts & Co.</u>, <u>supra</u>, if disclosure prior to effecting a sale would be unrealistic under the circumstances, the alternative is to fórego the transaction.

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report was cited in the Mining Hi Lites for the week ending August 23, On July 19, 1963, at Magnuson's request West Coast sent sales literature and other information to a representative of a securities firm which thereafter proposed to inventory and make a market in West Coast stock and Magnuson on September 4 told the representative that West Coast was "one of those rare situations that could be very profitable" and "could be an extremely fine vehicle, not only for the archery business, but for other types of recreational endeavor."

Under these circumstances, when the company's actual condition had to Magnuson's knowledge become radically different from the favorable image that he knew of and had himself fostered, it was improper for him to sell his shares without disclosure of the grave financial problems facing West Coast.

On the basis of the foregoing, we find that Pennaluna, together with or aided and abetted by Harrison and Magnuson, willfully violated the anti-fraud provisions of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 17 CFR 240. 10b-5 and 15cl-2 thereunder.

Bids for and Purchases of Stock During Distribution

Rule 10b-6 (17 CFR 240.10b-6) under the Exchange Act in pertinent part prohibits an underwriter or other participant in a distribution, or any person on whose behalf such distribution is being made, from directly or indirectly bidding for or purchasing the securities being distributed or any other securities of the same class and series, until he has completed his participation in the distribution. Distributions within the meaning of the Rule were effected when Pennaluna sold, to retail customers and other dealers, the 90,555 shares of Silver Buckle obtained in the Oil, Inc. transaction and the first 100,000 shares obtained in the New Park - East Utah transaction, when it resold the shares of Silver Buckle acquired through O'Brien from Magnuson and the shares of West Coast acquired from Magnuson, and when Magnuson sold about 238,500 shares of Silver Buckle to several broker-dealers other than Pennaluna between May 1962 and June 1963. During the periods of these distributions, Pennaluna bid for and purchased Silver Buckle and West Coast stock. 21/ It does not matter that, as respondents assert. Pennaluna did not engage in any special retail selling effort. 22/ Accordingly, we find that Pennaluna, Magnuson and Harrison willfully violated Section 10(b) of the Exchange Act and Rule 10b-6 thereunder.

^{21/} Pennaluna was an underwriter as to the 90,555 share and 100,000 share blocks as well as with respect to the shares purchased from Magnuson. As to the shares sold by Magnuson to other broker-dealers, Pennaluna's bids and purchases must be viewed as the indirect activities of Magnuson, a person on whose behalf the distribution was being made.

^{22/} Cf. J. H. Goddard & Co., Inc., Securities Exchange Act Release No. 7618, p. 4 (June 4, 1965) and cases cited in n. 8.

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Other Violations

Pennaluna, aided and abetted by Magnuson and Harrison, willfully violated Sections 7, $10(a_7, 15(c, 1), and 17(a)$ of the Exchange Act, Rules 17 CFR 240.10a-1, 15cl-5, 17a-3 and 17a-4 thereunder, and Section 4(c) (2) (12 CFR 220.4(c) (20) of Regulation 7 promulgated by the Board of Governors of the Federal Reserve System, as follows:

- Between January 1962 and November 1963, Pennaluna failed promptly to cancel or otherwise liquidate 54 purchases of securities in special cash accounts of customers, as to water full payment was not made within 7 business days as required by Section 4(c) (2) of Regulation 7.
- During the period between November 1960 and May 1963, Pennaluna, a member of the Spokene Stock Exchange, used the facilities of the Exchange to execute sell orders which were not marked either "long" or "short," as required by Rule lba-1.
- 3. During the period when Magnuson, a controlling person of Pennaluna, also was a controlling person of Silver buckle and West Coast. Pennaluna failed to comply with Rule 15c1-5 which regulies a broker-dealer under common control with an issuer of securities to disclose to a customer, before entering into a contract for the purchase or sale of such securities, the existence of such control and, if such disclosure is not made in writing, to supplement it with written disclosure at or before the completion of the transaction.

Respondents do not claim that the required disclosures were made, although they point to the fact that it was Pennaluna's general practice to indicate on confirmations that Magnuson was an officer or director of the issuer of the securities involved where that was the case. They assert that the failure to include such a legend on the confirmations covering transactions in West Coast stock was due to oversight, and further assert that they did not understand or consider that Magnuson was a controlling person of Silver Buckle. In our opinion, however, these factors cannot excuse the failure to comply with the requirements of the Rule. 23/

4. From about January 1960 to November 1960, Pennaluna failed to make and keep current, as required under Rule 17a-3, memoranda of brokerage orders and principal transactions, showing the time of execution or cancellation, a record of original entry showing securities received and delivered, a position record, and guestionnaires or applications for employment by employees. Moreover, Pennaluna failed to preserve originals of all communications received and copies of all communications sent, as required by Rule 17a-6.

While admitting that Pennaluma's records did not fully comply with "the Division's interpretation" of the applicable rules, respondents assert that such records did provide management with the information necessary for the operation of the business, and that registrant has installed records "of the type preferred by the Division." We have repeatedly stressed the importance in the regulatory scheme of the

^{23/} In any event, a statement on a confirmation that Magnuson was a director of West Coast would not have met the requirement of the Rule that it is the control relationship which must be disclosed, and that such disclosure first be made before entering into a contract with a distomer.

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requirement that books and records be kept current and in proper form, 24/ and have pointed out that, "It is obvious that full compliance with those requirements must be enforced, and registrants cannot be permitted to decide for themselves that in their own particular circumstances compliance with some or all is not necessary." 25/ We also note that as early as January 1961 our staff had advised Pennaluna that its books and records were not in compliance with most of the very requirements of Rule 17a-3 which we now find were not met, and that Magnuson had given assurance at that time that there would be full compliance in the future.

Public Interest

Respondents argue that the public interest would not be served by the imposition of stringent sanctions against them. They point out that Magnuson has severed his relationship with registrant and state that largely through his efforts, including large loans to and guarantees for West Coast, that company was able to settle the claims of its creditors and to save the mining properties for its stockholders. Harrison states that he has been a reputable securities dealer since 1929. Respondents further assert that effective steps have been taken to remedy "procedural defects," and that registrant serves a vital role as a market-maker for mining securities. In our opinion, however, the factors referred to by respondents cannot overcome the serious nature of the violations we have found. In view of these violations, we conclude that it is in the public interest to bar Harrison and Magnuson from association with any broker-dealer, to expel Harrison from embership in the Spokane Stock Exchange, and, on the basis of the willful violations by Harrison and Magnuson, to revoke registrant's broker-dealer registration.

An appropriate order will issue.

By the Commission (Chairman COHEN and Commissioners WOODSIDE, OWENS, and WHEAT), Commissioner BUDGE not participating.

Orval L. DuBois
Secretary

24/ See, e.q., <u>0lds & Company</u>, 37 S.E.C. 23 (1956); <u>Midland Securities</u>, <u>Inc.</u>, 40 S.E.C. 333, 339-40 (1960).

25/ Olds & Company, supra, at 26-27.

UNITED STATES OF AMERICA before the SECURITIES AND EXCHANGE COMMISSION April 27, 1967

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In the Matter of

PENNALUNA & COMPANY, INC. Radio Central Building Spokane, Washington

and

BENJAMIN A. HARRISON HARRY F. MAGNUSON

File No. 8-11752

Securities Exchange Act of 1934 -Sections 15(b) and 19(a)(3) ORDER REVOKING BROKER-DEALER REGISTRATION, BARRING ASSOCI-ATTON WITH BROKER-DEALER, AND EXPELLING FROM NATIONAL SECURITIES EXCHANGE

Private proceedings having been instituted pursuant to Sections 15(b) and 19(a)(3) of the Securities Exchange Act of 1934 to determine whether to take remedial action with respect to Pennaluna & Company, Inc., a registered broker and dealer, Benjamin A. Harrison, and Harry F. Magnuson;

A stipulation of facts having been entered into, hearings having been waived, briefs having been filed, and the Commission having heard oral argument;

The Commission having this day issued its Findings and Opinion; on the basis of said Findings and Opinion $\,$

IT IS ORDERED that the registration of Pennaluna & Company, Inc. as a broker and dealer be, and it hereby is, revoked; that Benjamin A. Harrison and Harry F. Magnuson be, and they hereby are, barred from being associated with any broker or dealer; and that Benjamin A. Harrison be, and he hereby is, expelled from membership in the Spokane Stock Exchange.

By the Commission.

Cival L. De Bris

Orval L. DuBois Secretary UNITED STATES OF AMERICA before the SECURITIES AND EXCHANGE COMMISSION July 6, 1967

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4661

In the Matter of

PENNALUNA & COMPANY, INC. Radio Central Building Spokane, Washington

ORDER DENYING PETITION FOR RECONSIDERATION

and

BENJAMIN A. HARRISON HARRY F. MAGNUSON

File No. 8-11752

Securities Exchange Act of 1934 -Sections 15(b) and 19(a)(3)

On April 27, 1967, the Commission issued its Findings, Opinion and Order (Securities Exchange Act Release No. 8063) revoking the broker-dealer registration of Pennaluna & Company, Inc. ("registrant"), barring Benjamin A. Harrison, registrant's sole stockholder, and Harry F. Magnuson, formerly a principal stockholder and officer of registrant, from being associated with a broker or dealer, and expelling Harrison from memborship in the Spokane Stock Exchange ("Exchange"). On May 1, 1967, the Commission stayed the effectiveness of its order pending determination of a petition for review to be filed by respondents. Registrant, Herrison and Magnuson subsiquently filed a petition requesting reconsideration of the Commission's decision and an opportunity to present additional evidence on the question of appropriate sanctions, and, having been granted permission to present such evidence in documentary form, submitted a statement with attached exhibits.

Petitioners urge that the Commission erred in that it found that Magnuson was a member of the control group of Silver Buckle Mining Company ("Silver Buckle") and West Coast Engineering, Inc., that Oil Incorporated was a member of Silver Buckle's control group during May 1962, that Pennaluna & Company ("Pennaluna"), registrant's predecessor, was an underwriter with respect to and effected distributions of certain blocks of Silver Buckle stock, and that in connection with such distributions petitioners violated the anti-fraud provisions of the Securities Exchange Act of 1934. They further argue that in finding violations by Pennaluna and Harrison based on statements made by Harrison to other securities dealers, the Commission applied standards created subsequent to the time of these statements. Politicages also contend that the Commission failed to evaluate properly their arguments regarding the appropriate sanctions. The additional material submitted by petitioners includes statements by them, as well as certain statistical information and newspaper and magazine articles, to the effect that the extence of an orderly market for the securities of silver mining companies operating in the Cocur d'Alene area serves the national interest in silver production as well as a widespread and increasing investor interest, that such a market is now provided by the Exchange and the Spokane over-the-counter market, and that the continuation of Harrison

and registrant, which deals primarily in such securities, in the mining securities market is important to the continued maintenance of an orderly market. In addition, petitioners submitted statements signed by members of the Exchange, by persons associated with Spokane offices of securities firms, and by the former manager of the Seattle office of a securities firm expressing their high regard for Harrison's character and ability, and their belief in his importance to the local mining securities markets.

The Commission noted that for the most part the petition merely attacked in general terms certain findings and conclusions of the Commission and it was of the view that no new facts or arguments warranting a modification of its decision had been presented. The Commission pointed out that, contrary to petitioners' argument, it had not found that Oil, Incorporated was a member of the control group of Silver Buckle, It further noted that the principle that misrepresentations made by one dealer to another may violate the anti-fraud provisions of the securities acts had been established many years prior to the statements here involved. See Van Alstyne, Noel & Company, 33 S.E.C. 311 (1952), cited at p. 9, n. 13 of the principal opinion in the instant case. With respect to the public interest issues, the Commission had in fact carefully considered the contentions previously advanced by petitioners. In view of the serious violations which it had found, it was of the opinion that the additional material submitted by petitioners did not warrant a modification of the sanctions imposed.

Accordingly, IT IS ORDERED that the petition for reconsideration be, and it hereby is, denied.

By the Commission (Chairman COHEN and Commissioners OWENS and WHEAT), Commissioners \mathtt{BUDGE} and \mathtt{SMITH} not participating.

Orval L. DuBois Secretary

Frual L. Sw Bois

The following letters dated October 7, 1963, October 15, 1963 and February 28, 1964 relate to the negotiations between West Coast Engineering, Inc. and the Brunswick Corporation. The Brunswick study was referred to at page 399 of the Record and it is stipulated that this investigation was being conducted during the months of October, November and early December, 1963. The following letters are not contained in the Record and are herewith presented to this Court because of the failure of the respondent's findings to refer to this study and to properly evaluate its effect upon Magnuson's expectation that West Coast would solve its financial difficulties during the Fall of 1963.

Pursuant to Section 25 of the Securities Exchange Act of 1934, petitioners shall apply to this Court for permission to include this additional evidence, if the Court feels that such a motion is required. The additional evidence bears directly on the financial condition of West Coast Engineering, Inc. from August, 1963, forward, and respondent's finding (R. 4618) (Appendix pages 118-119) of violations of the antifraud provisions of the Acts.

MEMO TO: Glen Sherman

FROM: H. F. Magnuson

Re; Brunswick - West Coast Engineering

As I have discussed with most of you individually, on Thursday October 3, I went to Chicago for a meeting with the Brunswick Corporation officials regarding WCE. The week previous I had discussed with Mr. W. L. Graham my interest in automated archery and he suggested I meet with Brunswick.

Graham is a college friend of Mr. Bensinger, President of Drunswick and as a result arranged a first-class meeting between myself and Brunswick officials. On Friday morning Mr. S. P. Jacobson, Senior Vice President had a conference all lined up on this matter. We had the Board of Directors room and those present were Mr. S. P. Jacobson, Senior Vice President, Axel A. Hofgren, Patent Attorney, Milton Rudo, Vice President and President of the Bowling Division, Marvin M. Komen, Director of Long Range Planning, and Anderson Fox. In addition, their vice pecident in charge of finance, and market research vice president and their head of the legal department were also present.

We had a full, complete and frank discussion of automated archery and West Goast from 9 a.m. until 1 p.m. At that time they cerved lunch in the same room and we discussed the matter further until 2:30.

At the outset I told them of my association with wCE and I was not technically qualified to speak on the various details of our products. However, there was no question they had arranged an outstanding reception for me and there was no question as to their tremendous interest in archery. They have been following archery very closely and were frank to say they had a great deal of interest in archery and this would give them an opportunity to study the matter further and make a decision in this regard.

As a matter of interest, Brunswick has \$550,000,000 of paper with respect to their bowling leases, much of valid is in trouble. They have found that the large bowling areas run something like our Downey and Denver installations, are in trouble. They now prefer the "Ma and Pa" small 8, 12 and 16 lane bowling installations.

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They had a man come up and show the WCE film on archery. They agreed this was an outstanding public relations job. I also showed them the film on the trap-o-natic.

During our discussion which was on a very friendly and frank basis, it was pointed out that many of the problems W.CE encountered and will encounter are very similar to those encountered by the bowing industry some 20 years ago. The two carallel each other quite closely. We discussed patents and I gave then, a copy of our patent letter from Mr. Mattern. I am enclosing a copy for you in case you haven't one.

They indicated that WCE may have made some mistakes but certainly had done a first-class job in bringing archery to the public and gaining good public relations on a tromendous coverage basis. They asked me if I had discussed the matter with AMF and I told them I had not and that about a year ago we had made an approach to AMF. They asked I not contact AMF at this time and that I give Brunswick an opportunity to make a thorough investigation and study of the situation.

They said that they were so serious about it that they would like to have 30 days to make a complete study of the market, production costs and financial aspect with respect to the project. They said in the event they determined a lack of interest sooner they would contact me and in any event they would like to make a complete study of it. I told them they would be most welcome and everything would be made available to them. I told them I hope they would not just study WCE and go into the archery business on their own. They said they wouldn't and they said if they went into the archery business they would best do it through WCE.

They discussed briefly the arrangement by which they might acquire our achery business. They suggested a a royalty or certain amount per lane sold with a maximum payoff. It was decided that nothing could be intelligently discussed on this phase of the situation until after their investigation.

However, I think it was generally understood that WCE was very desirous

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It would be not thought that we should keep our WCE empended to a minimum. I am hopeful of financing the Jama lease and that with those proceeds of paying the pressing accounts payable and enabling us to continue in business on a very numinum basis for the next 60 to 90 days. I am confident that inview of the interest of Funansiek that we will be able to interest a large purchaser in our archery and trap division. In view of the very gratifying reception I received in Chicago. I felt it would be inappropriate for me to neet with Pierson or continue to New York and meet with AMF.

John Quayle, Investment Advisor, in New York is a very fine personal friend of mine and happens to be acquainted with Mr. Mansfield Sprague, Vice President of AMF. If in the event at the end of 30 days Brunswick is not interested in WCE, I will have Quayle set up a meeting with AMF and I will go to New York and discuss it with them. If there is no interest there I will probably discuss the matter with Pierson.

After discussing this matter with Brunswick and based upon our own experiences, it is obvious that the archery business is an industry potentially as large as the bowling business. In view of the tren-nedous finances needed it is obvious that this development should be tied into a company that is tremendously large and well financed. Until this is done, we are going to have difficulty selling the lease paper and it will be unprofitable. In fact, I think Brunswick makes much of its profit from selling the lease paper.

This will give you a complete report on this trip and the enclosed letter to Mr. Komen regarding my discussing with Brunswick will be informative to you. As indicated, I would like to keep this confidential in order to enable us to make the full investigation with Brunswick.

If you have any suggestions, please advise.

Harry Magnuson

HFM:ed

cc: Dr F. E. Scott Jack D. Gay MEMO TO: Glen Sherman

FROM: H. F. Magnuson

Re; Brunswick - West Coast Engineering

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We had a full, complete and frank discussion of automated archery and West Coast from 9 a.m. until 1 p.m. At that time they served lunch in the same room and we discussed the matter further until 2:30

At the outset I told them of my association with wCE and I was not technically qualified to speak on the various details of our products. However, there was no question they had arranged an outstanding reception for me and there was no question as to their tremendous interest in archery. They have been following archery very closely and were frank to say they had a great deal of interest in archery and this would give them an opportunity to study the matter further and make a decision in this regard.

They had a man come up and show the WCE film on archery. They agreed this was an outstanding public relations job. I also showed them the film on the trap-o-matic.

During our discussion which was on a very friendly and frank basis, it was pointed out that many of the problems V.CE encountered and will encounter are very similar to those encountered by the bowling industry some 20 years ago. The two garallel each other quite closely. We discussed patents and I gave them a copy of our patent letter from Mr. Mattern. I am enclosing a copy for you in case you haven't one.

They indicated that WCE may have made some mistakes but certainly had done a first-class job in bringing archery to the public and gaining good public relations on a tremendous coverage basis. They asked me if I had discussed the matter with AMF and I told them I had not and that about a year ago we had made an approach to AMF. They asked I not contact AMF at this time and that I give Brunswick an opportunity to make a thorough investigation and study of the situation.

They said that they were so serious about it that they would like to have 30 days to make a complete study of the market, production costs and financial aspect with respect to the project. They said in the event they determined a lack of interest sooner they would contact me and in any event they would like to make a complete study of it. I told them they would be most welcome and everything would be made available to them. I told them I hope they would not just study WCE and go into the archery business on their own. They said they wouldn't and they said if they went into the archery business they would best do it through WCE.

They discussed briefly the arrangement by which they might acquire our achery business. They suggested a a royalty or certain amount per lane sold with a maximum payoff. It was decided that nothing could be intelligently discussed on this phase of the situation until after their investigation.

However, I think it was generally understood that WCE was very desirous of disposing of its trap and archery in order that it could preserve and retain its maning properties. As I indicated to you, my main desire at this time is to get this phase of our business properly financed and perhaps sold to return Silver Buckle back to its original status and enable it to retain its very valuable mining property for its shareholders. In view of the present silver situation and the anticipated improvements in the metal and silver market, this would be most beneficial to WCE shareholders.









Brunswick corporation EXECUTIVE OFFICES

October 15, 1963

Mr. H. F. Magnuson Scott Building Wallace, Idaho

Dear Harry:

During the phone conversation yesterday I indicated that I had been set up as the Project Leader to review the possibilities of indoor archery and specifically Vest Coast Engineering. In order to expedite our evaluation it is essential that your people in Seattle have available to us the following information: (this will save us a considerable amount of time and it will enable us to meet your schedule.)

Manufacturing and Research & Development

- 1. Complete engineering drawings.
- 2. Complete parts list.
- 3. Fart prints.
- 4. Frocess sheets.
- 5. Plant layout or flow chart.
- 6. List of purchase parts and vendors (also list tooling not owned).
- List of tooling, including vendor tooling (owned by W.C.E.) and value of tools (original and book).
- 8. List and cost of expense materials.
- 9. List and cost of raw materials.
- 10. List and cost of work in process.
- 11. List and cost of finished goods.
- 12. Real estate obligations.
- 13. Copy of labor contract if union shop.
- 14. What obligations if terminated.
- 15. Personnel on payroll by category (temporary and permanent).
- 16. Product cost sheets (labor, materials and burden).
- 17. What are average labor rates by classification.
- 18. Scrap and rework experience.
- 19. Organization charts functions and personnel.
- 20. We will want to take pictures of process and equipment.

Legal

Copies of all patents and patent pending applications.

Financial

Latest balance sheet (preferably September 36), profit and loss statements from date of incorporation.

Details on quarantors on notes, loans and recourse marketing.

Copies of market research reports prepared by V. . E. Jordan.

Complete information regarding resale of merchandise...bows, arrows, targets, etc., concerning pricing, cost and markups.

Leasing or sales/lease arrangements with leasing companies.

Copies of all distributor agreements.

Advertising, Publicity and Promotional Materials, Individual Installations, i.e. Burion and Coving

It is essential that Mr. Sherman obtains clearance for us to send a member of our market research team to visit each of the five installations where we can obtain

- A balance sheet, profit and loss statements from origin, a breakdown on sources of revenue.
- Detailed information regarding league development and open play, pro shop business broken down by type of sales, a record of former participants if available. (This is important so we can determine why these participants dropped out after trying the sport.)
- Interviewing participants regarding motivations and reactions to this activity, etc.

If all of the above can be started immediately it would help us out tremendously.

According to our schedule, I personally with Mr. Fox will visit Mr. Dumke in Salt Lake City on Monday and Tuesday. We plan to be in Seattle on Wednesday, October 23 at 3:30 Wat which time we would like to immediately start gathering our information. If Mr. Sherman

can have a good portion of information available for our manufacturing and engineering personnel it might be possible for me to have those individuals available in Seattle on Wednesday, October 23. This would give us a head start on the project. I will confirm this with Mr. Sherman by phone.

I would like to send a member of our market research group first to the Denver installation on Monday, Cotober 21, and he will spend approximately two or three days there evaluating the archery as well as trapomatic aspects. If Mr. Sherman can obtain the necessary clearance with the local operator it will greatly facilitate our timing as the longest lead times required will be the checkout of the installations and engineering.

If all timing goes properly we plan to have a preliminary report available for our Board on November 15 and thereby be in a position to meet the deadline we set up with you of 45 to 60 days for our firm to arrive at a decision.

Before I leave Seattle I will call you and bring you up to date as to our progress in getting the necessary information.

The information required above is not all-inclusive as we have a great deal of information to gather by discussion with Mr. Sherman, but the above information will facilitate the action which we will be required to take.

Sincerely yours,

Director of Long Range Planning

MMK/ad

cc: Mr. G. Sherman President West Coast Engineering Co. 818 S. Dakota Seattle 8, Washington February 28, 1964

MEMO TO: Glen Sherman

FROM: H. F. Magnuson

Re: West Coast Engineering, Inc.

Glen, as I mentioned to you, last Friday, Marvin Komen, Vice President of Brunswick called me on Thursday concerning WCE. He stated he had noticed in the Wallace Miner, which I sent him, that we had shipped an order to Kannimatsu. Apparently Kannimatsu is a competitor of theirs and one of the large Japanese concerns.

He mentioned Brunswick was taking another look at this and that hey had a special program under consideration for Europe. He asked me okeep him informed and they would have their thinking solidified in the text two weeks and he would be back in contact with us.

I would appreciate your sending me any information that you can bertaining to the status of the negotiations with Kannimatsu. Frankly would just as soon make a deal with Kannimatsu if a good one can be made hat will provide some cash. In any event, it is gratifying to see this nterest.

H. F. Magnuson

IFM:ed

c: Dr. F. E. Scott Jack D. Gay Richard Cary Alden Hull can have a good portion of information available for our manufacturing and engineering personnel it might be possible for me to have those individuals available in Seattle on Wednesday, October 23. This would give us a head start on the project. I will confirm this with Mr. Sherman by phone.

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If all timing goes properly we plan to have a preliminary report available for our Board on November 15 and thereby be in a position to meet the deadline we set up with you of 45 to 60 days for our firm to arrive at a decision.

Before I leave Seattle I will call you and bring you up to date as to our progress in getting the necessary information.

The information required above is not all-inclusive as we have a great deal of information to gather by discussion with Mr. Sherman, but the above information will facilitate the action which we will be required to take.

Sincerely yours,

Director of Long Range Planning

MMK/ad

cc: Mr. G. Sherman
President
West Coast Engineering Co.
818 S. Dakota
Seattle 8, Washington

February 28, 1964

MEMO TO: Glen Sherman

FROM: H. F. Magnuson

Re: West Coast Engineering, Inc.

Glen, as I mentioned to you, last Friday, Marvin Komen, Vice President of Brunswick called me on Thursday concerning WCE. He stated he had noticed in the Wallace Miner, which I sent him, that we had shipped an order to Kannimatsu. Apparently Kannimatsu is a competitor of theirs and one of the large Japanese concerns.

He mentioned Brunswick was taking another look at this and that they had a special program under consideration for Europe. He asked me to le ep him informed and they would have their thinking solidified in the next two weeks and he would be back in contact with us.

I would appreciate your sending me any information that you can pertaining to the status of the negotiations with Kannimatsu. Frankly I would just as soon make a deal with Kannimatsu if a good one can be made that will provide some cash. In any event, it is gratifying to see this interest.

H. F. Magnuson

HFM:ed

c: Dr. F. E. Scott Jack D. Gay Richard Cary Alden Hull



UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

1111 123

No. 22143

PENNALUNA & COMPANY, INC., BENJAMIN A. HARRISON and HARRY F. MAGNUSON,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of Orders of the Securities and Exchange Commission

BRIEF FOR RESPONDENT SECURITIES AND
EXCHANGE COMMISSION

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UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 22143

PENNALUNA & COMPANY, INC., BENJAMIN A. HARRISON and HARRY F. MAGNUSON,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION.

Respondent.

BRIEF FOR RESPONDENT SECURITIES AND EXCHANGE COMMISSION

JURISDICTIONAL STATEMENT

This is a petition by Pennaluna & Company, Inc., Benjamin A. Harrison and Harry F. Magnuson to review orders (R. 4622, 4661-4662) of the Securities and Exchange Commission entered April 27, 1967 and July 6, 1967 pursuant to Sections 15(b) and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. 780(b) and 78s(a)(3). Based upon findings (R. 4608-4621) of willful violations of various provisions of the Securities Act of 1933 ("Securities Act"), the Exchange Act and rules under the latter Act, the order of April 27, 1967 revoked the registration of Pennaluna & Company, Inc. as a broker and dealer in securities, barred Harrison and Magnuson from being associated with any broker or dealer, and expelled Harrison from membership in the Spokane Stock Exchange. The order of July 6, 1967 denied a petition for reconsideration of the earlier order. On September 1, 1967, petitioners filed their petition to review those orders in this Court pursuant to Section 25(a) of the Exchange Act, 15 U.S.C. 78y(a).

^{1/ &}quot;R. __" refers to pages of the record, and "Br. __" refers to pages of petitioners' brief.

STATUTES AND RULES INVOLVED

[Pertinent provisions of the Securities Act, the Exchange Act and rules under those Acts are set forth in full in the statutory appendix (pp. la et seq., infra). Summarized here are the provisions primarily involved on this review--the registration, antifraud and anti-manipulation provisions.]

As set forth in its preamble, the Securities Act of 1933 was enacted "[t]o provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof . . . " 48 Stat. 74. The preamble to the Securities Exchange Act of 1934 describes that Act as one "[t]o provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails . . . [and] to prevent inequitable and unfair practices on such exchanges and markets . . . " 48 Stat. 881.

Registration Provisions

The registration provisions of the Securities Act are designed to bring about the "full and fair disclosure" intended by Congress. Section 5 of that Act, 15 U.S.C. 77e, makes it unlawful to use the mails or interstate facilities to sell securities unless such securities are registered with the Commission. Sections 3 and 4 of the Securities Act, 15 U.S.C. 77c, 77d, exempt from the coverage of Section 5 various types of securities and securities transactions. The exemptions involved here are those specified in Sections 4(1) and 4(3). Section 4(1) exempts from registration, "transactions by any person other than an issuer, underwriter, or dealer"; and Section 4(3) exempts dealers' transactions where no distribution by an issuer or underwriter is involved. The

term "underwriter" is defined in Section 2(11) of the Securities Act, 15 U.S.C.

77b(11), as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking . . . " Section 2(11) further provides that, for purposes of determining who is an underwriter, "the term 'issuer' shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common

the issuer with a view to the distribution of those securities, or a person who offers or sells securities for a controlling person of the issuer in connection with the distribution of those securities, is an underwriter, and therefore the Section 4(1) and 4(3) exemptions are not available for such trans-

Both the Securities Act and the Exchange Act contain broad antifraud

Hence, a person who purchases securities from a controlling person of

Antifradd and Anti-manipulation Provisions

control with the issuer."

actions.

provisions. Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), and Sections 10(b) and 15(c)(1) of the Exchange Act, 15 U.S.C. 78j(b), 78o(c)(1), as implemented by Rules 10b-5 and 15cl-2 under the latter Act, 17 CFR 240.10b-5, .15cl-2, make it unlawful, through the use of the mails or interstate facilities in connection with the offer, purchase or sale of any security, to employ any device, scheme or artifice to defraud, to make any untrue statement of a naterial fact, to omit to state a material fact necessary to make statements made not misleading, to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, or to

^{2/} Section 2(2) of the Securities Act, 15 U.S.C. 77b(2), defines "person" to include an individual, a corporation, a partnership, and an association.

employ any other manipulative or deceptive device.

Rule 10b-6 under the Exchange Act, 17 CFR 240.10b-6, is a specific anti-manipulative rule which prohibits an underwriter or other participant in a distribution of securities, or any person on whose behalf such distribution is being made, from bidding for or purchasing the securities being distributed, or any other securities of the same class and series, until he has completed his participation in the distribution.

In Section 9 of the Exchange Act, 15 U.S.C. 78i, Congress prohibited various manipulative practices with respect to securities listed or registered on national securities exchanges. Section 9(a)(2) makes it unlawful to effect, alone or with one or more other persons, a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others."

The protection afforded by Section 9(a)(2) in the case of listed securities is extended to unlisted securities in the over-the-counter market by the general antifraud provisions discussed above. Thus, if it is proved that a person violated Section 9(a)(2) in all respects except that his manipulation was of the market of an unlisted rather than a listed security, a violation of the general antifraud provisions would be established.

The exemptions found in Sections 3 and 4 of the Securities Act apply only to the registration provisions of that Act and not to the antifraud provisions of that Act or of the Exchange Act.

Halsey, Stuart & Co., 30 S.E.C. 106, 111 (1950); Gob Shops of America, 39 S.E.C. 92, 104 n.20 (1959); Barrett & Co., 9 S.E.C. 319, 328 (1941).

STATEMENT OF THE CASE

A. Introduction

Pennaluna & Company, Inc. ("registrant"), one of the petitioners, is the corporate successor to the partnership of Pennaluna & Company ("Pennaluna") a Wallace, Idaho securities firm. The Pennaluna partnership, which had registered with the Commission as a broker-dealer in 1954, was composed after 1961 of petitioner Harrison, who owned a 62-1/2 per cent interest, and petitioner Magnuson, who owned a 37-1/2 per cent interest (R. 136). In September 1963 registrant was formed to take over the business of Pennaluna, and on November 29, 1963, its registration with the Commission as a broker-dealer became effective (R. 138). From September 1963 until after the institution of the proceeding below, Harrison and Magnuson held all of registrant's capital stock in the same proportions (62-1/2 per cent and 37-1/2 per cent respectively) as their interests in the preceding partnership (R. 138). Both Harrison and Magnuson were directors of registrant during this period, with Harrison also serving as president and Magnuson as secretary-treasurer (R. 137). Magnuson and Harrison were partners in Pennaluna at all times from September 1, 1954 until the time registrant took over Pennaluna's business in late 1963 (R. 136-138).

During the period involved in this proceeding, Harrison, a member of the Spokane Stock Exchange (R. 133), operated Pennaluna's Spokane office and was in charge of all trading activities of the firm (R. 141). Harrison also edited two publications, entitled 'Mining Hi Lites" and 'Brokerage Information Service Reports," which were published under the sponsorship of a group of Spokane dealers including Pennaluna (R. 144). 'Mining Hi Lites" was a weekly information sheet summarizing recent newspaper articles and other publications concerning various mining securities (R. 144). 'Brokerage Information Service

Reports" was published a few times a year, with each issue featuring a specific mining security (R. 144). Approximately 1,000 copies of each issue of "Mining Hi Lites" were reproduced for distribution (R. 147). Pennaluna would mail between 50 and 80 of these to certain persons and firms on Pennaluna's mailing list (R. 147). Magnuson was one of the persons to whom this publication was sent by Pennaluna (R. 2190).

Magnuson is a certified public accountant who has a large accounting practice in Wallace under the name of H. F. Magnuson & Co. (R. 148). During the period in question, Magnuson was also responsible for overseeing the operations of Pennaluna's offices at Wallace and Kellogg, Idaho, and was responsible for its record-keeping activities (R. 152).

The Commission found that Pennaluna, Magnuson and Harrison willfully violated the registration, antifraud and anti-manipulation provisions of the securities laws in connection with the sale of common stock of Silver Buckle Nining Company ("Silver Buckle") and West Coast Engineering, Inc. ("West Coast"). These violations consisted of: (1) various sales of unregistered shares of Silver Buckle and West Coast stock (R. 4610-4613); (2) a manipulation of the market in Silver Buckle stock (R. 4613-4619); (3) misrepresentations and omissions of material facts in the sale of Silver Buckle and West Coast stock (R. 4613-4619); and (4) bidding for and purchasing Silver Buckle and West Coast stock while engaged in distributions (R. 4619).

B. History of Silver Buckle and West Coast

This case arises out of petitioners' activities in connection with purchases and sales of the common stock of Silver Buckle from about May 8, 1962 until Silver Buckle was merged into West Coast on June 10, 1963, and petitioners' subsequent activities with respect to West Coast Stock.

Silver Buckle was a mining company incorporated in Idaho in 1947

(R. 2194). It had an authorized capital of 10 million shares of 10 cent

par value common stock (R. 3481). The prime figure in its incorporation was

Dr. Frank E. Scott, a Wallace, Idaho dentist (R. 157). Throughout Silver

Buckle's corporate existence Scott served as its president and as one of its findirectors (R. 157).

In July 1953, Silver Buckle acquired a 50 per cent working interest in the mining claims of Vindicator Silver-Lead Mining Company ("Vindicator"), a Wallace corporation (R. 161). Silver Buckle considered its investment in Vindicator to be a substantial part of its total assets (R. 2194-2201, 2217). Both Magnuson and Scott were members of Vindicator's five-man board of directors and Magnuson was the secretary and later the vice-president of Vindicator (R. 2231, 2909, 4244-4281).

As a part of the financing of exploratory work of Vindicator's claims and in purchasing Utah uranium claims in 1953, Silver Buckle, which then had approximately 5-1/2 million shares outstanding, transferred approximately 2 million additional shares of its treasury stock to New Park Mining Company ("New Park"). New Park in turn transferred part of this block of stock to East Utah Mining Company ("East Utah") and Oil, Inc. These three companies were based in Salt Lake City, Utah, and their management was centered in W. H. H. Cranmer, their president and general manager (R. 162). After this transaction, 4/Silver Buckle's five-man board of directors consisted of Scott, Jack D. Gay

^{4/} Gay was a business associate of Scott (R. 1552, 1553) and a partner of Gay and Scott, Investments (R. 206). Gay was treasurer, assistant secretary and a director of Silver Buckle from its inception until 1958. In 1958 he was appointed liquidating trustee of one of Scott's other corporations and, on advice of counsel, resigned as an officer and director of Silver Buckle (R. 162-163). However, he continued to act as Silver Buckle's office manager until February 1962 (R. 163).

and J. Alden Hull, all of Wallace, Idaho, and Crammer and Clark L. Wilson, both of Salt Lake City (R. 2194). When Gay resigned in 1958, his seat was taken over by Nolan Brown, another Wallace resident (R. 163).

In June 1960, Silver Buckle sold some of its uranium interests. After the sale the corporation remained relatively dormant while a place to invest its liquid assets of nearly \$1 million was sought (R. 164). The investment vehicle decided on was West Coast, a Washington corporation engaged in the development, manufacture and distribution of automated archery targets for sale or lease to operators of archery ranges (R. 165).

West Coast was a Seattle based firm incorporated in the fall of 1960 for the purpose of dealing in heavy equipment, including mining machinery (R. 165). Shortly after its incorporation, West Coast ventured into the field of automated archery targets (R. 165). By the middle of October 1961, West Coast was in financial trouble as the result of its efforts to develop and market its automated archery targets, and the company was in need of an immediate source of funds (R. 165, 166, 169). During that month, West Coast's president contacted Magnuson, and then Scott and Gay, in an effort to secure the needed financing (R. 166). In November 1961, Silver Buckle entered into an agreement with West Coast which gave it the right to obtain control of West Coast through purchases of Nest Coast stock (R. 166, 2268-2275). By February 1962, Silver Buckle

Hull was a partner in H. J. Hull & Sons, a Wallace law firm. Hull was Magnuson's personal attorney (R. 977), legal counsel for Pennaluna (R. 977), legal counsel for Silver Buckle (R. 158) and the secretary and a director of Silver Buckle (R. 162, 2231).

Magnuson asserts that although he asked West Coast's president to leave some West Coast literature with him, he was unable to pursue the matter in detail at that time (R. 1132).

Nolan Brown on its five-man board of directors, with Scott as its secretary, Gay its executive vice-president, and Nolan Brown as treasurer (R. 171).

Silver Buckle's directors then passed a resolution guaranteeing all of West Coast's present and future contractual indebtedness (R. 171).

Between February 6, 1962 and May 14, 1962, Silver Buckle made further cash purchases of stock from West Coast, and on the latter date increased its holdings to approximately 59 per cent of West Coast's outstanding stock by issuing to West Coast 1,999,998 shares of Silver Buckle stock in exchange for West Coast stock. By September 1962, Silver Buckle had acquired 88.41% of West Coast's outstanding stock (R. 167). At least by this date, and continuing until Silver Buckle was merged into West Coast on June 10, 1963, Silver Buckle's investment in West Coast represented, by far, its most important asset (R. 2217, 2229-2230). Silver Buckle's purchases of West Coast stock dried up the supply of West Coast stock available to the public. Hence, Silver Buckle became the trading vehicle for equities in West Coast's business, and West Coast so notified persons who inquired about its stock (R. 173; Br. 65).

By December 31, 1961, West Coast's cumulative deficit for the first 15 months of its operation had reached \$73,772 (R. 169), and during 1962 the situation deteriorated further.

West Coast had leased its first 16 automated archery lanes to an archery range located at Burien, Washington in September 1961 amid widespread publicity and newspaper coverage (R. 165; Br. 22). By April 1962 the Burien range was in financial difficulty, and consequently West Coast agreed to accept a 57% reduction in the range's rent during the late spring and summer months of 1962 (R. 193). On September 17, 1962, West Coast, in order to meet its cash needs, sold to a third party West Coast's contract under which it had leased archery equipment to the Burier range the previous year, together with its title to such equipment (R. 203). The

terms of the contract, however, gave the purchaser a right of recourse against West Coast (and Silver Buckle and its guarantor) for any future rent defaults on part of the lessee archery range. This right of recourse created a contingent liability of \$130,560 against the two companies (R. 203).

A second range was opened in Denver in late September 1962 (R. 2648).

By September 30, 1962, West Coast had incurred a cumulative deficit of

\$276,835 and a net loss of \$203,063 for the first nine months of 1962 (R. 2745).

Three additional ranges were opened in Portland, Oregon and in Downey and

Covina, California in late 1962 (R. 204). But by December 31, 1962, West

Coast's cumulative deficit had tisen to \$413,567 (R. 3004), indicating a net

loss of \$305,827 for the 10-month period March 1, 1962 - December 31, 1962.

West Coast continued to lose money during 1963 and 1964. As early as November 1962 and continuing through April 1964, Magnuson devoted a considerable amount of his time, skill and money to helping West Coast with its financial problems. On November 10, 1962, Magnuson inquired of Gay about the prospects of Golconda Mining Corporation ("Golconda") making an investment in West Coast (R. 254). (Magnuson was Golconda's vice president, a director, and its largest shareholder during 1962 and 1963. (R. 160, 2885-2907)) By December 1, 1962 it was agreed that Golconda, in exchange for options to purchase West Coast stock, would guarantee up to a maximum of \$420,000 of any recourse obligations of West Coast (and of Silver Buckle, as guarantor) that might arise out of West Coast's sales of additional leases on archery equipment which West Coast was then manufacturing and leasing to new ranges (R. 254). To provide security for Golconda, West Coast agreed to pledge its nearly 2,000,000 shares of Silver Buckle stock to Golconda, and Silver Buckle agreed to pledge

Golconda made various loans to West Coast totalling \$70,000, in some cases receiving options to acquire West Coast stock in repayment (R. 240, 254, 263, 287). However, in order to meet its cash needs West Coast still found it necessary, on January 28, 1963, to sell the four leases on its equipment at the Denver, Portland, Downey and Covina ranges, as well as title to such equipment, to a third party for cash (R. 288). Again the terms of the sale gave the purchaser a right of recourse against West Coast (and Silver Buckle as guarantor), creating contingent liabilities of \$851,000 (R. 288). At the time of this sale the Denver range was already in default on its rental payments to West Coast (R. 290). Due to the gains arising from these lease sales, West Coast's deficit was reduced from \$413,567 on December 31, 1962 (R. 3004) to \$167,478 for the year ended February 28, 1963 (R. 3312). For that year, however, West Coast suffered a net loss of \$59,736, notwithstanding the gains made on the lease sales (R. 3312). During the first three months of 1963. Magnuson assisted West Coast in its efforts to obtain equity capital from major securities firms and other sources (R. 269, 285, 3272, 3282, 301-302, 306). All of these efforts were unsuccessful. Shortly before March 4, 1963 he conferred with Gay on this subject and at that time was told that all of the \$770,000 which West Coast had obtained from the sale of its leases on January 28, 1963 had been spent (R. 301). By 7/ West Coast sold all of its leases on its five existing ranges during the fiscal year ending February 28, 1963. West Coast had no further archery leases available for sale until October 23, 1963 when it sold its Redwood City lease for \$164,000 shortly before the range opened, under terms

which required West Coast to pay the purchaser the minimum monthly rental payments with credit for any payments received by the purchaser from the lessee (R. 384). Magnuson and Golconda guaranteed up to \$60,000 of West Coast's \$259,200 recourse obligations created by the sale of this lease (R. 384). This was the sixth (and last) lease sold by West Coast before

it want out of huginoss in the saring of 1964 (\$ 414).

to Golconda its portfolio of mining securities valued at about

\$69,000 and give Golconda a first lien on all of its mining properties

including the Vindicator project (R. 254). Shortly thereafter, Magnuson and

he end of March, Magnuson knew that West Coast's prospective archery equipent installations were bogging down and that West Coast would soon have real ash problems (R. 306). On March 25, 1963 Magnuson conferred with Gay about the possibility of merging Silver Buckle into West Coast (R. 305). Magnuson as fully aware at this time of West Coast's financial problems (R. 306).

In April 1963, Magnuson spent considerable time with West Coast officials rying to work out all the problems faced by the company (R. 310-311), and arrison knew during this month that Magnuson was attending high level West past meetings (R. 309). By April 25, Magnuson knew the financial problems aced by the Denver, Portland, Downey and Covina ranges, including the fact hat some were behind in rental payments on their leases (R. 310). By the add of April the Downey range owed West Coast approximately \$12,000 on open account and \$4,212 in lease payments; the Covina range owed approximately \$22,837 to open account and \$4,681 in lease payments; and the Denver range owed approximate \$2,500 on open account and \$3,840 in lease payments (R. 317). The open count items for these ranges had been past due for the most part since about end of 1962 (R. 317). The Burien range owed West Coast at this time proximately \$11,564 which had accumulated since about May 19, 1962 without by payments having been made in the interim (R. 317).

Further consideration was being given to the possibility of a merger of liver Buckle and West Coast. About the middle of April 1963, Magnuson indited that he would recommend that the board of directors of Golconda acquiesce

The archery ranges had not been making their lease payments to the purchaser of the leases, and therefore West Coast had been required to make the payments pursuant to the terms of the contracts of sale.

uckle form a subsidiary (later named Silver Buckle Mines, Inc.) to hold all assets of Silver Buckle other than its West Coast stock and (2) all of the Silver Buckle Mines, Inc. stock be pledged to Golconda (R. 311).

These terms were agreed to and on May 3, 1963, Magmuson, Scott and Hull caused Silver Buckle Mines, Inc. to be incorporated (R. 322). Magmuson became an incorporator, stockholder and director of Silver Buckle Mines, Inc. (R. 2231). On May 24, 1963 Magmuson also became a director of West Coast and was instrumental in having two others elected as directors and in having one of them elected president (R. 331).

On June 10, 1963 the merger of Silver Buckle into West Coast took place with Silver Buckle stockholders becoming entitled to receive one share of West Coast stock for each five shares of their Silver Buckle stock (R. 331). This merger made Silver Buckle Mines, Inc. a wholly-owned subsidiary of West Coast (R. 336).

The financial condition of West Coast at this time was very serious. On June 11, 1963, Magnuson (who was now a director of the merged company) received a copy of West Coast's financial statements showing a loss in the month of May of \$37,522, and showing a cumulative deficit on May 31, 1963 of \$334,657 (R. 338).

On June 26, 1963, Magnuson received a letter from the president of West Coast stating that the company's cash requirements through October for the production of archery equipment and the payment of "old accounts payable" were estimated to be \$302,480, and that no further archery installations were anticipated during that time (R. 3572-3573). West Coast's financial statements as of

^{9/} The fact that the deficit had been \$167,478 on February 28, 1963 indicates that West Coast also lost money in March and April 1963.

June 30, 1963 showed total cash of only \$33,836 (R. 3565), and a loss for that month of \$31,000 (R. 345, 3566).

West Coast lost another \$30,000 in July 1963 (R. 355), and had a deficit of \$416,836 at the end of that month (R. 355). Magnuson was kept constantly aware of the growing financial crisis (R. 354).

By July 1963 the archery ranges were in desperate financial straits.

The Covina range was losing money at the rate of \$9,000 a month (R. 352). The Downey range had lost \$43,416 for the six-month period of January 1 to

June 30, 1963 (R. 353). The Portland range was over \$140,000 in debt (R. 358).

The Denver range lost \$141,626 during the year ended August 31, 1963 (R. 3618).

About September 16, 1963, West Coast discontinued its pro shop and rental stock business, and disposed of its entire stock of pro shop merchandise (R. 369).

During this time Magnuson and Golconda continued in their role as major creditors of West Coast. Both Magnuson and Golconda continued to make sizeable loans to West Coast during the latter part of 1963 (R. 364, 371, 379).

On October 4, 1963, West Coast sent Magnuson a letter concerning West Coast's financial problems (R. 376). This letter indicated that the Portland, Denver, Downey and Covina ranges owed West Coast a total of over \$250,000 as of that date (R. 3625). As things continued to get worse for West Coast, Magnuson was kept fully informed (R. 389).

By early December 1963, West Coast considered going into Chapter XI bankruptcy proceedings (R. 401) and a special meeting of directors was called on January 13, 1964 to explore that possibility (R. 412). At this meeting it was agreed that West Coast should discontinue the archery business (R. 412).

On February 21, 1964, Magnuson, on the advice of his attorney, Hull, resigned as a director of West Coast because of conflicting interests

engendered by Magnuson's positions with other corporations (R. 416). Magnuson recommended that Robert N. Brown be elected as a director of West Coast to fill the vacancy caused by his resignation. Brown was so elected (R. 421).

By May 1, 1964, West Coast had dismissed all but three or four employees, was no longer engaged in manufacturing archery equipment, and was liquidating its machinery, supplies and office equipment (R. 422). At this time the archery ranges were either closed or in the process of closing down (R. 422).

C. Ruby Silver Mines, Inc.

About September 1961, Scott asked Magnuson if Pennaluna would underwrite 10/
a proposed Regulation A offering by Ruby Silver Mines, Inc. ("Ruby Silver"),
a Silver Buckle subsidiary which had formerly been operated by Silver Buckle,
New Park and East Utah as a joint venture. Shortly after this request,
Magnuson became a director of Ruby Silver (R. 189). Ruby Silver's nine-man
board of directors then included all of Silver Buckle's officers and its five
directors--Scott, Wilson, Hull, Crammer and Nolan Brown (R. 2454).

While Silver Buckle was acquiring an increasingly larger interest in

West Coast during the spring of 1962, Ruby Silver's proposed Regulation A

offering through Pennaluna was being prepared by H. J. Hull & Sons. On

April 25, 1962 an underwriting contract between Pennaluna and Ruby Silver was

executed by Scott on behalf of Ruby Silver, and by Harrison on behalf of Pennaluna

after discussing the matter with Magnuson (R. 188). Shortly thereafter, on

11/

May 1, contracts were executed by Ruby Silver and its stockholders for the

^{10/} Regulation A under the Securities Act of 1933, 17 CFR 230.251, et seq.

^{11/} These stockholders included Silver Buckle, New Park, East Utah, Scott, Magnuson, Hull, Nolan Brown, Wilson, Crammer and Crammer's son, Robert L. Crammer (R. 190-191).

placing of their Ruby Silver stock in escrow in compliance with Regulation A requirements (R. 190-191).

D. Oil, Inc. Transaction

In December 1961, Cranmer announced that he would resign as president of the three companies which he controlled (New Park, East Utah and Oil, Inc.) to become the chairman of New Park's board of directors (R. 174). He intended to turn over the management of New Park and East Utah to Charles A. Steen, a "prominent entrepreneur" who had made a substantial investment in New Park stock (R. 174). Cranmer's son Robert was to manage Oil, Inc. (R. 174). At that time, Oil, Inc., New Park and East Utah each owned approximately 600,000 shares of Silver Buckle stock (R. 174).

During the early part of 1962, Steen was in the process of ousting the Cranmers from all three of the Utah-based companies. At the same time Steen indicated to Scott his disapproval of the management of Silver Buckle (R. 176). When Steen attempted to obtain control of Oil, Inc. (and the 600,555 shares of Si Buckle stock which Oil, Inc. owned), Scott arranged with the younger Cranmer 12/for the sale of these shares to Scott at 10 cents per share (R. 176, 1982).

Because Scott needed financial assistance in making the purchase, he contacted Magnuson, who agreed to help (R. 176, 1983).

Scott and Magnuson agreed that each of them would take what portion of the stock he could, and that they would try to get a few of their friends and relatives interested in the stock also (R. 1983-1984). Magnuson contacted Harris and at Magnuson's urging Harrison agreed that Pennaluna would purchase 100,000 shares of this block of 600,555 shares, even though it was not Pennaluna's usual

Contrary to petitioners' assertion (Br. 14) that Robert Crammer initiated this transaction by contacting Scott, Scott testified that he did not remember whether Robert contacted him or he contacted Robert (R. 1982).

procedure to purchase such large blocks of stock (R. 570, 181).

On May 8, 1962 0il, Inc. carried out its commitment to Scott by authorizing its officers to accept an offer from Magnuson to purchase its 600,555 shares of Silver Buckle stock at a price of 10 cents per share for a total purchase price of \$60,055.50. This stock was placed in escrow in a Wallace bank under an arrangement which enabled Magnuson to acquire these shares by delivering to the escrow agent a check drawn against his personal account in the amount of \$60,055.50 (R. 2371-2374).

The result of the transaction as finally consummated was that Magnuson and accounts for his children (of which he was custodian) paid for 172,000 of the 600,555 shares, and Pennaluna, with the approval of Harrison, paid for 90,555 shares. The remaining shares were either paid for by Scott or sold by Magnuson and Scott to others (R. 178-179).

E. Sales of Unregistered Securities

Pennaluna had completed resale of its block of 90,555 shares by July 14, 1962 at prices ranging from 13 cents to 20 cents per share (R. 182). These shares were sold by Pennaluna to various of its retail customers and to other broker-dealers (R. 2395-2397).

F. New Park-East Utah Transaction

By June 1962, Steen was in complete control of New Park and East Utah (R. 196, 197). On August 17, 1962, Steen once again expressed his displeasure at the way Silver Buckle was being managed and tried to unseat Scott as president of Silver Buckle (R. 196). Steen then caused New Park

^{13/} Scott, Gay and Nolan Brown already owned a combined total of about 1 million shares of Silver Buckle stock (R. 1946).

and East Utah to start selling off their holdings in Silver Buckle in large blocks through a Salt Lake City brokerage house (R. 196).

Silver Buckle, acting as its own transfer agent, agreed to transfer these shares only after a legal opinion was provided by New Park's attorneys on August 24, 1962, which stated that in their opinion neither New Park nor East Utah was a control person of Silver Buckle (R. 196, 1439-1440).

Scott became deeply concerned about the depressing effect which these sales of large blocks of Silver Buckle stock by New Park and East Utah would have on the market price of the stock (R. 2013-2014, 2021). Scott was also concerned about Steen's refusal to approve Ruby Silver's proposed public offering through Pennaluna (R. 2022, 197). As a consequence, Scott and Hull began negotiating with Steen's attorney in an attempt to resolve their differences (R. 197). When these attempts failed, Scott asked Magnuson to try to resolve the situation (R. 197).

New Park and East Utah owned 1,167,111 shares of Silver Buckle stock, and Silver Buckle was willing to purchase only 367,111 of these shares. Steen let it be known that any settlement would be conditioned upon the sale, by New Park and East Utah, of the 800,000 shares of Silver Buckle stock which Silver Buckle itself was not willing to purchase (R. 2025). Magnuson agreed to acquire these 800,000 shares at 20 cents a share, with the understanding that Scott would take 300,000 of these shares, and that Pennaluna, with darrison's approval, would purchase 200,000 of these shares (R. 199, 200).

On September 29, 1962 a plan of settlement was worked out at a meeting arranged by Magnuson. This plan called for two contracts, one between Silver Buckle, New Park and East Utah for 367,111 shares of Silver Buckle stock, and a contract between Magnuson, New Park and East Utah for 800,000 shares (R. 198). The silver Buckle, New Park-East Utah agreement provided, among other things, that Silver Buckle, New Park-East Utah agreement provided, among other things, that Silver Buckle, New Park-East Utah agreement provided, among other things, that Silver Buckle, New Park-East Utah agreement provided, among other things, that Silver Buckle, New Park-East Utah agreement provided, among other things, that Silver Buckle, New Park-East Utah agreement provided, among other things, that Silver Buckle, New Park-East Utah agreement provided, among other things, that Silver Buckle, New Park-East Utah agreement provided, among other things, that Silver Buckle, New Park-East Utah agreement provided, among other things, that Silver Buckle, New Park-East Utah agreement provided, among other things, that Silver Buckle, New Park-East Utah agreement provided, among other things, that Silver Buckle, New Park-East Utah agreement provided, among other things, that Silver Buckle, New Park-East Utah agreement provided provi

Buckle would cause Magnuson, Scott and Hull to transfer to New Park and
East Utah their stock interests in Ruby Silver (R. 2595-2596). Of the
800,000 shares of Silver Buckle stock which Magnuson contracted to purchase
from New Park and East Utah on September 29, 1962, a total of 200,000 shares
were eventually paid for by Pennaluna, Scott paid Magnuson for 220,000 shares,
Hull paid for 10,000 shares, and Magnuson paid for the remaining 370,000
shares (R. 199-201). With respect to Pennaluna's 200,000 shares, 100,000
shares were paid for by a Pennaluna check for \$20,000 dated October 3, 1962
(R. 199).

G. Bidding and Trading - Manipulation of the Market

During the entire month of September 1962, just prior to the manipulation 15/
found by the Commission, the bid quotations in the Spokane sheets for
Silver Buckle were in the range of 15 cents to 17-1/2 cents, and
Pennaluna, which submitted quotations on 16 days, was high bidder
on only 2 days, and was high together with other firms on only 4 other
days, with these 6 days all in the first half of the month (R. 2442). In
this month it purchased for its own account only 1,000 shares of Silver Buckle
on the open market, and sold for its own account a total of only 15,000 shares
(R. 2941-2944). Pennaluna's last quotations for the month were 16 cents bid,
20 cents asked, on September 27 (R. 2442).

^{14/} The remaining 100,000 shares were taken down by Pennaluna in November 1962 and January 1963 (R. 2402-2427).

^{15/} During the period under consideration Pennaluna and other Spokane dealers listed their inter-dealer bid and asked prices for local mining stocks, including Silver Buckle, in quotation sheets (the "Spokane sheets") that were used to make a composite quotation sheet distributed to the news media and to the Commission for each trading day (R. 209-210).

During the last 12 days of September 1962, immediately preceding

Magmuson's negotiations with New Park and East Utah, Pennaluna made no

purchases of Silver Buckle stock on the open market, and made only five

sales totalling 6,000 shares sold at 17 to 18=1/2 cents per share to two

dealers and two retail customers (R. 2399). In this same period it submitted

to Spokane dealers low and intermediate bids coupled with intermediate offers

(R. 2442). At the end of September Pennaluna had a "long" position in

Silver Buckle stock of 13,005 shares (R. 208). On Friday, September 28, 1962,

the last business day of the month, Silver Buckle shares were quoted by

Spokane dealers at 17 cents bid, 20 cents asked, with Pennaluna submitting

no quotations and making no purchases or sales (R. 2442).

The picture changed dramatically, however, as soon as Pennaluna became committed to acquire 200,000 shares of Silver Buckle stock by virtue of the New Park-East Utah transaction.

On Monday, October 1, 1962 (the first trading day after Magnuson executed the New Park=East Utah contract) Pennaluna purchased for its own account 11,500 shares of Silver Buckle stock from four Spokane dealers in seven transactions at prices ranging from 18-1/2 cents to 23 cents per share while making sales of 17,300 shares to 7 retail customers for its own account at prices ranging from 20 cents to 25 cents per share, with no sales to other dealers (R. 209, 2399).

On this same day, Pennaluna came back into the Spokane sheets for silver Buckle stock with the high bid of 22 cents, 3 cents higher than the next nighest bid, and with one of the two high ask quotations at 25 cents (R. 2442). For the week of October 1 to 5, 1962, Pennaluna was the high bidder on October 1, 3 and 4 (R. 2442). During that week Pennaluna purchased for its

account 46,300 shares of Silver Buckle stock at prices ranging from 81/2 cents to 26 cents a share and made sales for its own account of 200 shares of Silver Buckle stock at prices ranging from 20 cents to 7 cents a share (R. 2945-2952).

Of the 92 broker-dealers in various parts of the country who had ensactions in Silver Buckle stock from September 1, 1962, through Decem-4, 1962 (R. 253), Pennaluna made purchases totalling 46,300 shares for own account during the business week of October 1-5, 1962, nine other oker-dealers purchased a combined total of 22,700 shares that week, and remaining 82 broker-dealers made no purchases (R. 2945-2952).

For the week of October 8 to 12, 1962, Pennaluna was the high lider in the Spokane sheets on four days and one of the high bidders on a other day (R. 2442). During that week Pennaluna purchased for its account 52,000 shares of Silver Buckle stock at prices ranging from cents to 29 cents a share and sold for its own account 47,405 shares Silver Buckle stock at prices ranging from 24 cents to 30 cents per are (R. 2953-2961). Only ten of the remaining 91 dealers purchased any liver Buckle for their own account. Their purchases totaled 53,113

res (R. 2953-2961).

For the week of October 15-19, 1962, Pennaluna was the high bidder on ur days (R. 2442). For that week Pennaluna purchased for its own account, 000 shares of Silver Buckle stock at prices of 25 cents to 30 cents a share d sold for its own account 25,400 shares of Silver Buckle stock at prices nging from 29 cents to 31 cents a share (2961-2966). Only seven of the remaining dealers purchased any Silver Buckle for their own account. Their purchases taled 29,500 shares (R. 2961-2966).

For the week of October 22-26, 1962, Pennaluna was the high bidder on I five days (R. 2442). For that week Pennaluna purchased for its own account

15,000 shares of Silver Buckle stock at prices ranging from 20 cents to 30 cents per share and sold for its own account 24,100 shares of Silver Buckle stock at prices ranging from 26 cents to 29-1/2 cents per share (R. 2967-2975).

Only 14 of the remaining 91 dealers made any purchases for their own account. Their purchases totaled 98,900 shares, most of which were purchased by these 14 dealers on October 26, 1962 (R. 2967-2975), the day Harrison predicted that Silver Buckle was "headed for \$1" (p. 25, infra).

In the succeeding weeks Pennaluna continued its bidding and trading activities in the same fashion.

On the basis of the trading information with respect to Pennaluna and the other 91 broker-dealers for the period September 1, 1962 to December 4, 1962, Pennaluna, as one of the 32 most active broker-dealers in Silver Buckle stock, made all of its purchases and sales for its own account, involving a cotal of 532,600 shares purchased and 562,205 shares sold (R. 2938). This colume of trading was equivalent to 41,97 per cent of the combined purchases by the 32 dealers for their own accounts, and 39.62 per cent of their combined cales (R. 2938-2940). The total trades, as dealer, by these 32 broker-dealers involved a total of 2,687,836 shares of which Pennaluna was a buyer or seller of 1,094,805 shares, or 40.73 per cent of the total trading volume (R. 2936-1940).

For the month of December 1962, Pennaluna's trading ledger shows that t purchased for its own account 282,500 shares of Silver Buckle stock. Of these, 0,000 had been acquired in the New Park-East Utah transaction but Pennaluna had ailed to record them previously (R. 2410-2417). During the month its sales for ts own account amounted to 259,100 shares at prices ranging from 60 cents to \$1.02 er share (R. 2410-2417).

During the period October 1, 1962 to January 8, 1963, Pennaluna submitted ids on all but two trading days. Out of 56 days on which Pennaluna and at least ne other firm submitted bids, Pennaluna was the high bidder on 34 days, and on 3 days its bid was equal to the high. On 7 additional days Pennaluna was the inly bidder (R. 2442-2443). By January 8, 1963 the price of Silver Buckle stock eached a high of \$1.40 per share, a rise of 700 per cent in just over three months (R. 2447).

For the period from January 1, 1963 to July 2, 1963, Pennaluna purchased 628,613 shares for its own account, and sold for its own account 547,640 shares, leaving it with a "long" position of 47,373 shares which were converted into West Coast stock as a result of the June 10, 1963 merger between those companies (R. 2417-2437). During this period Pennaluna was either the high bidder for Silver Buckle stock in the Spokane sheets or one of the high bidders with one or more other dealers on 93 of 108 business days for which bids were submitted, and was the high or only bidder on 87 of these days (R. 2443-2447).

The highest bids submitted in the Spokane sheets during the entire period from October 1, 1962 to the end of the bidding for Silver Buckle stock on

June 10, 1963 were the two \$1.40 bids submitted by Pennaluna and L. E. Nichols

16/
Co. on January 8, 1963, after a nearly steady rise from October 1 (R. 2442-2447)

^{.6 /} L. E. Nichols & Co. had occupied offices for the preceding 15 years in rooms adjoining Pennaluna's Spokane office (R. 210).

[/] See graph at R. 1892.

H. Teletype Conversations - Misrepresentations

During the period that Pennaluna was actively bidding and trading Silver Buckle stock, Harrison engaged in a number of teletype conversations with various broker-dealers around the country. On Monday, October 1, 1962, the first business day after Magnuson had executed the New Park-East Utah contract, Harrison engaged in a teletype conversation with May & Co., a New York City broker-dealer who had traded in Silver Buckle stock in the past with Pennaluna. In response to the question, ". . . [W]hat goes . . .?", Harrison quoted a price of 19 cents a share for 5,000 shares of Silver Buckle and then said, "Steen's attorney here Saturday and a deal signed up so [there] will be no more Salt Lake stock available . . ." (R. 211, 2663). Harrison did not tell May & Co. that in fact 200,000 shares of "Salt Lake stock" had been acquired by Pennaluna, who was planning to sell it over-the-counter.

Harrison continued to "sell" Silver Buckle in these teletype messages, while at the same time indicating that he was in control of the Silver Buckle market. In a message of October 4, 1962, Harrison said, "This Silver Buckle will be the big one out here and all over the country soon. . . . It's 23-25 and will be 65 one of these days, so don't get caught on it. . . . Don't want [the] market up right now. Certain deals being signed between company and Steen, etc., but it will take off. It's [a] terrific deal . . . orders coming in for that archery stuff from all over world" (R. 214, 2737).

The statement that Harrison did "not want the market up right now" was due to the fact that the rise in the price of Silver Buckle stock immediately after the signing of the New Park-East Utah contracts on September 29, 1962 caused embarrassment to the officials of New Park and East Utah who had just sold 800,000 shares at 20 cents a share (R. 214). It was feared that New Park and East Utah might not go through with the deal (R. 214). Therefore, Harrison

onsummated. This can be seen by reference to a teletype conversation arrison had with May & Co. on October 19, 1962. In response to the uestion, "What is making Silver Buckle easier . .?", Harrison replied, Salt Lake wants a low quote on it to justify their sale to Silver Buckle -- o accommedating them -- won't last long, couple of days is all . . ."

R. 228, 2865). By October 26, 1962 Harrison felt free to tell May & Co. hat "Silver Buckle headed for \$1" (R. 238), and about November 10, 1962, drrison, replying to an inquiry from E. E. Smith & Co. (a broker-dealer), said, The big deal here is Silver Buckle. It is going to sell much higher. Archery rusiness deal taking over like wildfire" (R. 242).

On December 10, 1962, May & Co., referring to the New Park-East Utah transaction, asked Harrison by teletype: ". . . East Utah and New Park had 1,200,000 shares [of Silver Buckle]. Silver Buckle got 367,000. Where did the balance go?" Harrison replied, ". . . the balance was bought by Dr. Scott and associates and a bank and is not for sale and is off the market." May & Co. replied, "That what I wanted to know. That stock cannot be sold" (R. 2990). In fact, 200,000 shares were very much on the market and being sold by Pennaluna. At no time did Harrison disclose to May & Co. or any other broker-dealer that Pennaluna had directly or indirectly acquired a block of Silver Buckle stock from New Park or East Utah (R. 257).

On February 8, 1963, in response to an inquiry from May & Co., "Are the Nest Coast people showing a profit each month?", Harrison replied, "Yes, and getting better every day -- every time they open up one [of] those deals it's like making a new rich strike in a mine" (R. 295, 3280). On March 18, 1963, in a teletype conversation with May & Co., Harrison predicted that the price of liver Buckle would hit \$2 before the end of the year (R. 303). And on March 21, 963, Harrison told another broker-dealer not to "get caught short" (R. 303).

Petitioners concede (R. 607, 214-215) (Br. 34, 67-69) that

Harrison's statements and price predictions with regard to Silver Buckle

and West Coast were made without the benefit of any current financial
information concerning either of these companies.

I. Additional Sales of Unregistered Securities

By December 4, 1962 the price of Silver Buckle had been driven up to 80 cents a share (R. 2411, 2443). Profiting from the price rise, Pennaluna had, by this date, sold to retail customers and other broker-dealers 100,000 of the 200,000 shares of Silver Buckle which it had acquired by virtue of the New Park-East Utah transaction (R. 2402-2411).

Magmuson was also selling Silver Buckle stock during 1962 and 1963. Bett July 1962 and June 1963 Magnuson for his own account and as custodian for his children sold about 238,500 shares of Silver Buckle to persons and broker-dealer other than Pennaluna (R. 425-429). Of these shares all but 3.500 were sold after the price of Silver Buckle began its spectacular climb in October 1962 (R. 425). Between November 9, 1962 and December 24, 1962, Magnuson sold 52,500 of the 55,000 shares of Silver Buckle he had acquired as custodian for his children in the Oil, Inc. transaction, at prices ranging from 22 cents to 80 cents per share (the other 2,500 shares having been sold previously) (R. 425). In the same fashion he sold the 117,000 shares of Silver Buckle he had acquired in his own name in the Oil, Inc. transaction, mostly to other dealers over a period extending from about September 30, 1962 to about May 22, 1963, at prices ranging from 20 cents to \$1.40 per share (R. 425-428). The remaining 66,500 shares of Silver Buckle which Magnuson sold between July 1962 and June 1963 were shares which Magnuson had purchased in a number of other transactions (R.423

At least some of these 238,500 shares were resold by the broker-dealer purchasers

to public investors (R. 235-237, 239, 425-429).

J. O'Brien Transactions -- Further Sales of Unregistered Securities

In view of the sudden and spectacular rise in the price of Silver Buckle stock, the Commission began an investigation of the matter. Pennaluna first became aware of this investigation about December 5, 1962 (R. 253).

Representatives of the Commission's Seattle Regional Office conferred with Magnuson on January 10, 1963 concerning the Commission's investigation of Silver Buckle stock (R. 275). In the course of this discussion Magnuson assured these representatives that he did not intend to sell any more of the stock acquired in the New Park-East Utah transaction until the matter with the Commission was cleared up (R. 278-279). At about this time he told Harrison the substance of his discussion with the Commission's representatives, and Pennaluna's remaining 100,000 shares of the stock which it had acquired in the New Park-East Utah transaction were charged to the personal drawing accounts of Harrison and Magnuson in proportion to their interests in the firm. The certificates for these shares were then placed in an envelope marked "Special Transactions," and the envelope was placed in a safety deposit box in a Wallace bank (R. 278-279).

On March 5, 1963, Scott sent a letter to Harrison and other dealers concerning the Commission's investigation of Silver Buckle stock (R. 302).

The letter indicated that the Silver Buckle shares bought by the individual 18/
purchasers in the New Park=East Utah transaction might be subject to registration under the Securities Act before they could be sold (R. 3319).

^{18/} As opposed to the shares bought by Silver Buckle itself in that transaction.

In spite of Magnuson's assurances to the Commission's representatives on January 10, 1963 that no more of the Silver Buckle stock which had been acquired in the New Park-East Utah transaction would be sold until the matter with the Commission had been cleared up, and notwithstanding the implied warning on this same subject set forth in Scott's letter of March 5, 1963 to Harrison, on May 2, 1963 Magnuson and Harrison started selling off the 100,000 shares of Silver Buckle stock which they had placed in the "Special Transactions" envelope four months earlier (R. 319-320). Their sales of this stock were made to Pennaluna in 12 transactions spread over a period continuing to June 18, 1963. at prices ranging from 55 cents to 61 cents per share. These sales were made to Pennaluna through the account of Jerry T. O'Brien, Harrison's cousin (R. 137). in amounts of 5,000 and 10,000 shares (R. 319-320). Pennaluna would send a check to O'Brien, who would deposit it in his personal account and then issue his personal check to Magnuson for the full amount of the proceeds, less 1/2 cent per share (R. 320). Magnuson and Harrison shared the proceeds from these sales according to their proportionate partnership interests (R. 320).

Pennaluna resold these 100,000 shares to certain of its retail customers and to other broker-dealers over a period extending to about July 11, 1963, after more than 30,000 shares had been converted into West Coast stock (R. 319, 2434-2437, 3717-3720). Prior to and during Pennaluna's purchase and resale of these shares neither Pennaluna, Harrison, Magnuson nor any person representing them contacted any representative of the Commission's staff to ascertain whether the question of Magnuson's control position with respect to Silver Buckle had been resolved or to inquire whether the 100,000 shares or any portion there-of could be freely traded (R. 320).

K. West Coast Transaction -- Further Sales of Unregistered Securities

In September 1963 Pennaluna purchased, from Magnuson and from the

rustodian accounts for Magnuson's children, 5,250 shares of West Coast stock
which had been acquired from West Coast in December 1962. Pennaluna then resold
'50 of these shares (R. 424, 430).

. Magmuson's Sales of West Coast Stock -- Failure to Disclose Material Information

At least by the summer of 1963 it was apparent that West Coast was in lesperate financial circumstances (see pp. 13-14, supra). Notwithstanding this fact, the image being created for the public was that of a highly promising enterprise enjoying considerable success in the field of automated archery lanes -- and Magnuson himself contributed to furthering that image.

From January 1962 and continuing through September 1963, "Mining Hi Lites" bublished more than 30 articles which pictured West Coast as a company enjoying continued success in the field of automated archery lanes (R. 743-777).

In early July 1963, Magnuson was in contact with North's Financial Publications of San Francisco and provided the publisher with a copy of 19/West Coast's annual report (R. 358-359). The August 15, 1963 edition of this publisher's newsletter was entitled, "PIONEER AND LEADER IN RAPIDLY GROWING FIELD OF AUTOMATED INDOOR ARCHERY, WITH PROMISING SILVER PROPERTIES," and went on to state, among other things, that West Coast-equipped archery ranges were enjoying a steady rise in business, that West Coast had an excellent sales backlog (4-5 million dollars) and prospects, and that it would take many years of rapidly expanding sales for West Coast to come close to filling its share of

^{19/} This annual report contained a report by West Coast's president that the company had experienced "a healthy corporate growth," that \$5,000,000 of orders had been accepted, and that additional archery installations were to be made in eight states (R. 3290). These statements were published in various newspaper articles in the spring of 1963 (R. 3321; West Coast scrapbook, Vol. II, p. 22).

the potential market (R. 3602). The publication was cited in 'Mining Hi Lites' for the week ending August 23, 1963 (R. 363).

On July 19, 1963, at Magnuson's request, Gay sent financial information and literature concerning West Coast to Richard Madden, a representative of a San Francisco securities firm which later (about August 16, 1963) proposed to inventory West Coast stock and make a market in it (R. 353). Magnuson informed Madden by letter on September 4, 1963 that he thought West Coast was "one of those rare situations that could be very profitable" and "could be an extremely fine vehicle, not only for the archery business, but for other types of recreational endeavor" (R. 366).

Although Magnuson, a director and controlling person of West Coast, knew that the company's favorable public image was far different from the company's actual condition, he sold 24,101 shares of West Coast stock to persons other than Pennaluna during the period August 1963 through December 1963 (R. 430) admittedly never disclosing to the buyers of these securities any information he then knew concerning West Coast's serious financial condition (R. 431).

M. Violations

1. Registration Provisions

Silver Buckle, if not himself actually in control"; that therefore Pennaluna's sales of the 90,555 Silver Buckle shares acquired in the Oil, Inc. transaction and Pennaluna's sales of the first 100,000 shares of Silver Buckle stock acquired in the New Park-East Utah transaction were made "for or on behalf of a controlling person of the issuer"; and that, accordingly, Pennaluna was an "underwriter" within the meaning of Section 2(11) of the Securities Act and the sales of these

The Commission found that Magnuson was "a member of a control group in

O/ Petitioners admit that none of the Silver Buckle or West Coast shares involved this proceeding were reigstered with the Commission under the Securities Act (R. 432).

The Commission further found that, in view of Magnuson's controlling position in Silver Buckle and West Coast, Pennaluna was an underwriter with regard to the 37,500 Silver Buckle shares it purchased from Magnuson in the O'Brien transactions and the 750 West Coast shares it purchased from him in the West Coast transaction, and that therefore the sale of these unregistered shares by Pennaluna violated the registration provisions (R. 4612-4613).

With respect to the responsibility of Harrison, who, as Pennaluna's trader, effected the sales of unregistered securities for Pennaluna, the Commission found that he "was aware of facts which put him on notice that distributions of control stock might be involved" (R. 4613).

The Commission further found that the transactions in which Magnuson sold unregistered shares of Silver Buckle stock to broker-dealers other than Pennaluna, who resold these shares to the public, also violated the registration provisions (R. 4613).

Accordingly, the Commission held that Pennaluna, Magnuson and Harrison willfully violated the registration provisions of the Securities Act (R. 4613).

2. Antifraud and Anti-manipulation Provisions

The Commission found that Harrison made false and misleading statements in his teletype conversations with other broker-dealers, in violation of the antifraud provisions of the Securities Act and the Exchange Act (R. 4615-4617, 4619)

The Commission also found that "Pennaluna's bidding and trading in the stock [of Silver Buckle] and its obvious motive for raising the price level, coupled with [the] misrepresentations by Harrison to other dealers relating to the Silver Buckle stock and bullish predictions as to its future market price . . . make it clear that Pennaluna and Harrison engaged in a manipulative scheme in the sale of that stock," in violation of the antifraud provisions (R. 4614, 4619).

with respect to the responsibility of Magnuson for this manipulative and fraudulent conduct, the Commission found that "as an active major partner [in Pennaluna] he had a duty to know of the nature and scope of the firm's activities, and being chargeable with knowledge, he must be held to have at least a shared responsibility for the violations which occurred" (R. 4617).

The Commission further found that Magnuson's sales of West Coast stock during the period August through December 1963, without disclosure of the information he knew about West Coast's serious financial condition, also constituted violations of the antifraud provisions (R. 4617-4619).

Finally, the Commission found that Pennaluna, in contravention of Rule 10b-6, bid for and purchased Silver Buckle and West Coast stock during the periods Pennaluna and Magnuson were distributing their shares (R. 4619).

Accordingly, the Commission held that Pennaluna, Harrison and Magnuson willfully violated the antifraud and anti-manipulation provisions of the Securities Act and the Exchange Act (R. 4619).

3. Other Violations

In addition to the foregoing violations, petitioners stipulated (R. 433-441), the Commission found (R. 4620-4621) and petitioners admit in their brief (Br. 78) that Pennaluna, aided and abetted by Magnuson and Harrison, willfully violated Sections 7, 10(a), 15(c)(1) and 17(a) of the Exchange Act, 15 U.S.C. 78g 78j(a), 78o(c)(1), 78q(a); Rules 10a-1, 15c1-5, 17a-3 and 17a-4 thereunder, 17 CFR 240.10a-1, 15c1-5, 17a-3, 17a-4; and Section 4(c)(2) (12 CFR 220.4(c)(2)) of Regulation T promulgated by the Board of Governors of the Federal Reserve System. These violations consisted of: (a) failure to liquidate purchases of securities in customers' accounts, as required by Section 4(c)(2) of Regulation T (b) executing sell orders which were not marked either "long" or "short," as

required by Rule 10a-1; (c) failure to disclose control as required by Rule 15c1-5; (d) failure to make and keep current certain records, as required under Rule 17a-3; and (e) failure to preserve originals of all communications received and copies of all communications sent, as required by Rule 17a-4.

SUMMARY OF ARGUMENT

There is substantial evidence to support the Commission's findings that
Magnuson was a controlling person of Silver Buckle and West Coast throughout
the entire period that the stock of those companies was being distributed, and that
Harrison knew or should have known that distributions of control stock were taking
place. The Commission properly placed the burden on the petitioners to prove
their claim that the sales of that stock were exempt from the registration provisions of the Securities Act.

There was also substantial evidence to support the finding that Harrison, Magnuson and Pennaluna willfully violated the antifraud and anti-manipulation provisions of the securities laws by making false and misleading statements concerning the price of Silver Buckle stock, the desirability of West Coast as an investment and West Coast's financial condition, by manipulating the market in Silver Buckle stock, and by bidding for and purchasing such stock while engaged in its distribution. The finding that Magnuson further violated the antifraud provisions by selling West Coast stock without disclosing material information known to him by virtue of his position as an insider of that company is also supported by substantial evidence. The Commission was correct in requiring only a preponderance of the evidence to prove the fraud violations.

The sanctions imposed by the Commission were well within its discretionary authority, and petitioners' objections to the conduct of the Commission's staff are untimely and in any event are without merit.

^{21/} Petitioners have admitted the use of the requisite jurisdictional means in connection with all of their activities involved herein (R. 130-132; R. 432-435; R. 437-439; R. 441).

ARGUMENT

Section 25(a) of the Exchange Act, which confers jurisdiction on this Court, provides that "the finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." Accord, Section 10(e)(B)(5) of the Administrative Procedure Act, now codified as 5 U.S.C. 706(2)(E).

The courts have consistently held that an administrative agency's findings of fact are presumed to be supported by substantial evidence and that a petitioner who challenges those findings must specifically designate those findings 22/ for which he claims that there is no substantial evidence. Under the standard of substantial evidence the Commission has the responsibility both of resolving conflicts in the evidence and of drawing necessary inferences from the record. The reviewing court is not to determine where the weight of the evidence lies. Its function is limited to determining whether there was, in fact, substantial evidence to support the Commission's findings. As the Supreme Court said in Rochester Telephone Corp. v. United States, 307 U.S. 125, 147 (1939):

Having found that the record permitted the Commission [Communications Commission] to draw the conclusion that it did, the court travels beyond its province to express concurrence therewith as an original question. The judicial function is exhausted when there is found to be a rational basis for the conclusion of the administrative body.

^{22/} Keele Hair & Scalp Specialists, Inc. v. Federal Trade Commission, 275 F.2d 18, 21 (C.A. 5, 1960); Steelco Stainless Steel, Inc. v. Federal Trade Commission, 187 F.2d 693, 694-695 (C.A. 7, 1951).

National Labor Relations Board v. Marcus Trucking Co., 286 F.2d 583, 591-592 (C.A. 2, 1961); Standard Distributors, Inc. v. Federal Trade Commission, 211 F.2d 7, 12 (C.A. 2, 1954); Archer v. Securities and Exchange Commission, 133 F.2d 795, 799 (C.A.8), certiorari denied, 319 U.S. 767 (1943); Hartford Gas Co. v. Securities and Exchange Commission, 129 F.2d 794, 796 (C.A. 2, 1942).

^{24/} Consolo v. Federal Maritime Commission, 383 U.S. 607, 619-620 (1966); Wright v. Securities and Exchange Commission, 112 F.2d 89, 94 (C.A. 2, 1940).

- THE COMMISSION'S FINDING THAT PETITIONERS WILLFULLY VIOLATED THE REGISTRATION PROVISIONS OF THE SECURITIES ACT IS SUPPORTED BY SUBSTANTIAL EVIDENCE.
 - A. One Who Claims an Exemption from the Registration Provisions of the Securities Act Has the Burden of Proving that the Exemption Is Applicable.

Since the Securities Act is a remedial statute, it has long been the rule that the terms of an exemption from the Act are strictly construed against the \frac{25}{25}\end{aligned} claimant of its benefit. And, as the petitioners concede (Br. 48), it has long been the rule that the claimant of an exemption bears the burden of proving that the exemption is in fact applicable in his particular case. Securities and \frac{26}{26}\end{aligned} Exchange Commission v. Ralston Purina Co., 346 U.S. 119 (1953).

Notwithstanding the long line of authorities in support of these principles, petitioners now ask this Court to "clarify" the holding of the Supreme Court in Ralston Purina, and hold that in the instant case the burden was upon the Commission's Division of Trading and Markets ("Division") to prove that the 4(1) and 4(3) exemptions were not applicable to the transactions in question. Petitioners assert that such a rule is dictated by Section 7(d) of the Administrative Procedure Act, now codified as 5 U.S.C. 556(d), which provides, in pertinent part: "Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof." Petitioners assert that any other rule would constitute an "abuse of administrative due process of law" (Br. 48).

^{25/} Securities and Exchange Commission v. Joiner Leasing Corp., 320 U.S. 344, 353, 355 (1943); Securities and Exchange Commission v. Sunbeam Gold Mines Co., 95 F.2d 699 (C.A. 9, 1938); cf. Black v. Magnolia Liquor Co., 355 U.S. 24, 26 (1957).

Accord, Greater Iowa Corp. v. McLendon, 378 F.2d 783, 790 (C.A. 8, 1967);
Securities and Exchange Commission v. Van Horn, 371 F.2d 181, 187 (C.A. 7, 1966); United States v. Tehan, 365 F.2d 191, 196 (C.A. 6, 1966); Capital Funds, Inc. v. Securities and Exchange Commission, 348 F.2d 582, 586 (C.A. 8, 1965); Prudential Insurance Company of America v. Securities and Exchange Commission, 326 F.2d 383, 386 (C.A. 3, 1964); Securities and Exchange Commission v. Culpepper, 270 F.2d 241, 246 (C.A. 2, 1959).

Section 7(d) of the APA was not intended to disturb the traditional allocation of the burden of proof between parties to an adjudicative proceeding. This is evidenced by that section's opening clause, which reads, "Except as other wise provided by statute . . . " Petitioners admit that the Securities Act has been construed by the Supreme Court to require that the person claiming an exemption, rather than the Commission, have the burden of proving that the exemption is applicable. Ralston Purina, supra. Hence the Securities Act falls squarely within the exception provided in Section 7(d).

Petitioners agree that to place the burden of proof upon the claimant in the case of a distribution from an <u>issuer</u> is "consistent with administrative due process" (Br. 48). But they argue that to place this burden on the claimant when the distribution emanates from a controlling person of the issuer violates due process (Br. 48). Petitioners' theory for distinguishing in this manner between issuers and controlling persons is unclear, and no authority is cited for their novel proposition that such a distinction should be drawn. On the contrary, the House Committee Report on the Securities Act stated that one of the functions of the last sentence of the definition of underwriter, defining "issuer" to include not only the issuer but also persons controlling the issuer, was:

. . . to bring within the provisions of the bill redistributions whether of outstanding issues or issues sold subsequently to the enactment of the bill. . . . Such a public offering may possess all the dangers attendant upon a new offering of securities. . . . $\underline{28}$ /

Hence, in the instant case Section 7(d) required only that the Division have the burden of proving that the mails or the facilities of interstate commerce had been used to sell securities which were not registered under the Securities Act.

The burden then shifted to petitioners to prove that the transactions involved were exempt from registration. Cf. Edwards v. United States, 312 U.S. 473,

^{27/} And see, National Labor Relations Board v. Mastro Plastics Corp., 354 F.2d 170 (C.A. 2), certiorari denied, 384 U.S. 972 (1965).

^{28/} H. Rep. No. 85, 73d Cong., 1st Sess. (1933), p. 13.

482-483 (1941), where the Supreme Court upheld a conspiracy indictment under the Securities Act charging the sale of unregistered securities against an attack that the indictment failed to charge that the securities sold were not exempt from registration. We submit that, in view of the broadly remedial purposes of federal securities legislation, imposition of the burden of proof on a person who would plead the exemption is both fair and reasonable.

Lastly, petitioners argue that administrative due process was violated because (1) petitioners did not know the theory the Division was using in regard to the issue of control (Br. 49-50), and because (2) the Commission concluded that Magnuson was a control person, "a contention not raised by the Division and therefore not directly dealt with by petitioners" (Br. 50).

It should be pointed out initially, with respect to these arguments, that petitioners stipulated they received due and adequate notice of the issues to be determined in this matter (R. 132). In addition, the facts showed, and petitioners argued strenuously (R. 3999-4007), that the only persons involved whose control status was in question were Magnuson, Oil, Inc., New Park and East Utah. All the petitioners had to show to prove their exemption was that none of these people were in control of Silver Buckle during the period in question.

The Commission found that Magnuson was a controlling person of Silver Buckle (R. 4612). The question of Magnuson's control was argued extensively before the Commission in the brief filed by the Division (R. 3917-3928) and in the brief filed by the petitioners (R. 4007-4021).

B. Magnuson was A Controlling Person of Silver Buckle and of West Coast.

Petitioners admit (Br. 57, 58, 74) that the sale of West Coast stock by $\frac{29}{}$

As to the other transactions, petitioners argue that the "whole record" does not support the Commission's finding that Magnuson was a controlling person, and they further argue that the Commission failed to make "specific, responsible findings" (Br. 51-52).

Contrary to petitioners' assertions, the Commission was careful to set forth its findings with great care, and after a review of the whole record (R. 4609), the Commission stated that "... Magnuson and Scott were in effective control of Silver Buckle ..." (R. 4612). The Commission also found that Magnuson as a controlling person of West Coast (R. 4613). The Commission went on to state specifically its reasons for these findings (R. 4612; p.42, infra). There is substantial evidence to support the Commission's decision.

 A finding of control depends upon the circumstances found in each particular case.

defined "control" to mean "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." This definition is a reflection of the view expressed in the House Committee Report on the Securities Act that

The Commission, in Rule 405 under the Securities Act, 17 CFR 230.405, has

Petitioners' argument that a Section 4(4) exemption would have been available had this transaction been handled in another manner is not properly before the Court. Petitioners never raised the Section 4(4) argument before the Commission, and Section 25(a) of the Exchange Act provides, in part, that "no objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission." See note 38, infra. In any event petitioners have the burden of proving this exemption, and they have not shown that they met the 1% test, that there were no solicitations, or that Magnuson (Pennaluna's principal) was not an underwriter. See Rule 154 under the Securities Act, 17 CFR 230. 154.

[t]he concept of control herein involved is not a narrow one, depending upon a mathematical formula of 51% of voting power, but is broadly defined to permit the provisions of the Act to become effective wherever the fact of control actually exists. $\underline{30}/$

The Communications Act of 1934 uses the identical control language which is 31/
found in the Securities Act definition of the term underwriter. The

Supreme Court, in discussing the meaning of control as used in Section 2(b)
of the Communications Act, set forth what has now become a well-settled

principal in administrative adjudication of the issue of control:

Investing the Commission [Federal Communications Commission] with the duty of ascertaining "control" of one company by another, Congress did not imply artificial tests of control. This is an issue of fact to be determined by the special circumstances of each case. So long as there is warrant in the record for the judgment of the expert body it must stand. $\underline{32}$ /

Control, the Commission has held under the Securities Act, "is not synonymous with direct operation of an enterprise"; it "may be inferred from $\frac{33}{}/$ the conduct of the parties." It follows that control can rest with a group

^{30/}H.Rep. No. 85, 73d Cong., 1st Sess. (1933), p. 13, and see Stadia Oil & Uranium Co. v. Wheelis, 251 F.2d 269, 275 (C. A. 10, 1957).

^{31/} Section 2(b) of the Communications Act of 1934, 47 U.S.C. §152(b).

^{32/} Rochester Telephone Corp. v. United States, 307 U.S. 125, 145 (1939).

Reiter-Foster Oil Corp., 6 S.E.C. 1028, 1044 (1940). And see Securities and Exchange Commission v. Franklin Atlas Corp., 154 F.Supp. 395 (S.D. N.Y., 1957) where the manager of a real estate venture who was neither a director, officer nor stockholder was found to be "in control" for purposes of Section 2(11) of the Securities Act.

of persons, such as the members of the corporation's management (both directors and officers), or a number of business associates.

2. The Control Factors in the Instant Case

Magnuson's association with Scott and Silver Buckle goes back to at least 1950, when Magnuson's accounting firm did some work for Silver Buckle (R. 157). Scott and Gay, in turn, had securities accounts at Pennaluna (R. 3009-3010). In addition Hull, one of the three Wallace residents on Silver Buckle's board of directors, was Magnuson's personal attorney, as well as legal counsel for Pennaluna, legal counsel for Silver Buckle, and secretary and a director of Silver Buckle. It should also be noted that when West Coast's president went in search of funds in the early fall of 1961, it was Magnuson who was initially contacted (R. 166).

Magnuson and the three Wallace directors were involved in various corporate endeavors together. These business interrelationships are set forth in a table found at page 2231 of the record. One of the most important of these interrelationships was that involving Vindicator Silver-Lead Mining Company.

As previously stated (p. 7, supra), one of Silver Buckle's principal assets was a 50% working interest in Vindicator's mining claims. Magnuson was the vice president and a director of Vindicator (R. 160). Scott was also a director of Vindicator (160). Two of the other three directors of Vindicator were August Voltolini, a business partner of Magnuson, and S. K. Garrett, an incorporator of West Coast and one of its first directors (R. 160). S. K. Garrett was the brother-in-law of Bryan Dickinson, and

^{34/} II Loss, Securities Regulation 779 (2d ed. 1961) and cases there cited.

^{35/} Common counsel is one indication of control. J. P. Morgan & Co., Inc., 10 S.E.C. 119 (1941).

ne of the certified public accountants employed by Magnuson's accounting firm tas the secretary of Vindicator (R. 160).

Vindicator's mining claims adjoined those of the Lucky Friday Silver-Lead Mining Co. ("Lucky Friday") (R. 161). Magnuson was a vice president and lirector of Lucky Friday (R. 161). The two largest stockholders in Lucky Friday were the Hecla Mining Company and Golconda Mining Company (R. 175). Magnuson was a director of Hecla and Magnuson's accounting partner was the president and a director of Hecla (R. 175). Magnuson was also the largest shareholder of Golconda and was a controlling person of that company (p. 10, supra).

From 1961 on, the management of Vindicator had been negotiating with the management of Lucky Friday in regard to the development of Vindicator's properties from the bottom of the Lucky Friday mine (R. 161). Since Vindicator was a principal asset of Silver Buckle, any increase in the worth of Vindicator would inure to be the benefit of Silver Buckle. Hence, even though Magnuson did not take part in the actual negotiations between Vindicator and Lucky Friday (R. 161), his position with respect to these companies could reasonably be taken into account by the Commission on the question of Magnuson's influence on Silver Buckle's affairs.

It was with these facts as a background that the Commission examined the transactions involved herein, commencing with the Oil, Inc. transaction in May 1962. It should be remembered that Magnuson's influence in Silver Buckle was exerted through Scott and the other Wallace directors. Had Steen been successful in ousting Scott from his position in Silver Buckle, Magnuson's influence in that company would have been lost. Additionally, by the time of the New Park transaction in September 1962, Scott, Magnuson and

the custodian accounts for Magnuson's children owned substantial amounts of Silver Buckle stock, and Steen was depressing the price of these shares through sales of large blocks of stock through a Salt Lake City brokerage house.

The Commission found that Magnuson provided the assistance Scott needed to buy up the Silver Buckle stock controlled by Steen, that he provided assistance in seeing to it that large blocks of these shares were acquired by people friendly to Scott (including Magnuson himself, his children's custodian accounts and Pennaluna) and that he provided assistance in disposing of the remainder of the shares to new owners who would not pose the threat to the market indicated by Steen. It thus appears that when Scott, who was concededly a controlling person of Silver Buckle, became concerned with the threat to his status posed by Steen, he turned to Magnuson, and Scott and Magnuson thereafter became allied in repelling Steen and, in the process, in directing the course of events involving Silver Buckle. By virtue of this alliance and concerted activity, together with the other relationships discussed above, it is clear that Magnuson was a member of a control group of Silver Buckle. This conclusion is reinforced by the fact that at the moment Magnuson signed the New Park-East Utah contract he was in a position to control in excess of 11 per cent of the Silver Buckle stock then outstanding (not including the shares that had been issued in May 1962 to West Coast in

xchange for West Coast stock).

Magnuson's controlling position in Silver Buckle grew stronger during ate 1962 and early 1963, and he was elected a director of West Coast in May 963, shortly before Silver Buckle was merged into it in June of that year. etitioners apparently concede that by April 1963 (prior to the O'Brien ransactions) and certainly by the time of the West Coast transaction September 1963), Magnuson was a controlling person of Silver Buckle and West coast (Br. 54, 55, 57, 74, 78). Magnuson's and Golconda's roles as creditors, lagnuson's activities in trying to secure financing, his continued efforts to olve West Coast's problems and his election as a director, all as set forth in the history of West Coast at pp. 10 - 15, supra, fully support such a finding.

Petitioners argue that each transaction found to be in violation of the registration provisions must be viewed separately rather than as part of a continuing course of events (Br. 54-55). Although the evidence is sufficient

36/	The	shares	controlled	by	Magnuson	are	25	follows:	

largest stockholder (R. 179, 2085-2097; 3047-3048)

<u>Description</u>	Shares
Shares Magnuson acquired in the New Park-East Utah transaction (p. 19, supra).	370,000
Shares Pennaluna acquired in the New Park-East Utah transaction (p. 19, supra).	200,000
Shares of Silver Buckle held by Pennaluna in a "long" position on September 29, 1962 (R. 2394-2399).	13,005
Shares remaining from Oil, Inc. transaction for account of Magnuson individually and as custodian for his children (R. 423-431, 3036-3046).	169,500
Shares owned by Magnuson from a time prior to the Oil, Inc. transaction (R. 423).	542
Shares held by McGee Building, Inc. of which Magnuson was a 49% stockholder (R. 179, 3035).	10,000
Shares held by Golconda Mining Company, of which Magnuson was then an officer, director, and the	70,000

to support a finding of control even if petitioners' approach is employed, we submit that such an approach represents an unduly narrow and restrictive application of a broadly remedial statute. In a situation such as the instant one, where the same parties are involved in a series of transactions extending over a substantial period of time, and where these parties have a history of business relationships commencing before the first transaction in question, the correct approach in determining control is to look at the entire period involved, rather than to treat each transaction as an isolated event. Viewed in this manner, it is clear that the Commission properly found Magnuson to be a controlling person throughout the entire period that Silver Buckle and West Coast stock was being distributed.

C. Harrison Knew or Should Have Known That Distributions of Control Stock Were Taking Place.

The Commission found that "Harrison was aware of facts which put him on notice that distributions of control stock might be involved" (R. 4613). There is substantial evidence to support this finding. As the Commission informed the brokerage community in a release entitled "Distribution by Broker-Dealers of Unregistered Securities" (footnotes omitted):

. . . [A] dealer who offers to sell, or is asked to sell a substantial amount of securities must take whatever steps are necessary to be sure that this is a transaction not involving an issuer, person in a control relationship with an issuer or an underwriter. For this purpose, it is not sufficient for him merely to accept "self serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts."

Harrison, who was Pennaluna's trader, was aware of the restrictions applicable to the sale of unregistered securities by controlling persons (R. 141). As evidenced by the Brokerage Information Service Reports which Harrison caused

^{37/} Securities Exchange Act Release No. 6721, CCH Fed. Sec. L. Rep. ¶4845.835 (Feb. 2, 1962).

be published between June 1961 and November 1962 (R. 778, 780, 2909), trison knew of Silver Buckle's interest in Vindicator and of Magnuson's nuection with Vindicator and Lucky Friday. Harrison was aware as early 1961 that Scott might be a controlling person of Silver Buckle (R. 158). was also aware that Magnuson had twice purchased large blocks of Silver ckle stock after coming to some sort of arrangement with Scott.

Harrison knew of Magnuson's conversation with members of the Commison's Seattle Office in January 1963 and knew that one of the questions raised as whether Magnuson was a controlling person of Silver Buckle (R. 320). arrison knew of Magnuson's resolve not to sell any more of the stock acquired the New Park-East Utah transaction until this question was settled. Because f this control question, Pennaluna's second block of 100,000 shares acquired a the New Park-East Utah transaction was purchased by Harrison and Magnuson, laced in an envelope marked "Special Transactions" and placed in a bank safety eposit box (p. 27, supra). The possible need for registration had been further mpressed upon Harrison by the March 5, 1963, letter he had received from Scott p. 27, supra, and R. 3319). Yet when Pennaluna began selling off the Silver uckle stock it purchased in the O'Brien transactions, Harrison never asked the ommission, or indeed any attorney whatsoever, if the question of control had been leared up, or if the stock was free to be traded (R. 141,320). Instead, he urportedly relied on two legal opinions which had been given some nine months

The opinion of New Park's attorneys, addressed to Silver Buckle and ated August 24, 1962 (R. 1439-1440), did not deal with the question of Magnuson's ontrol position (p. 18, supra). The October 5, 1962 legal opinion, prepared by full's law firm for Magnuson, failed to give consideration to the influence resulting from Magnuson's participation with Scott in the Oil, Inc. and New Park-

reviously (Br. 56).

East Utah transactions -- a participation of which Harrison was well aware.

As early as January 1963 (R. 269) and at least by April 1963 (R. 309), Harrison was aware that Magnuson was taking an active part in West Coast's affairs. And by the time of the West Coast transaction Harrison knew that Magnuson was a director of West Coast (R. 364).

- II. THE COMMISSION'S FINDING THAT PETITIONERS WILLFULLY VIOLATED THE ANTIFRAUD AND ANTI-MANIPULATION PROVISIONS OF THE SECURITIES ACT AND THE EXCHANGE ACT IS SUPPORTED BY SUBSTANTIAL EVIDENCE.
 - A. In an Administrative Proceeding of a Remedial Nature the Proper Standard of Proof Is the Preponderance of the Evidence.

Petitioners argue that the Commission erred in applying the "preponderance of the evidence" standard of proof in the administrative proceeding below.

Petitioners assert that, because misrepresentations were alleged and because

of the nature of the sanction imposed by the Commission, the Commission was

required to apply a standard "akin to the 'clear and convincing' concept for

the proof of fraud in common law actions" (Br. 61-62).

At the outset it should be noted that this argument was never urged before the Commission and, accordingly, under Section 25(a) of the Exchange Act, 15 U.S.C. 78y(a) (see note 29, supra), petitioners are precluded from urging it before this Court. In any event, petitioners' argument is without merit.

^{1963);} Gearhart & Otis, Inc. v. Securities and Exchange Commission, 324 F.2d 772, 773 (C.A. 9, 1963); Gearhart & Otis, Inc. v. Securities and Exchange Commission, 348 F.2d 798, 800-801 (C.A. D.C., 1965); Gilligan, Will & Co. v. Securities and Exchange Commission, 267 F.2d 461, 468 (C.A. 2), certiorari denied, 361 U.S. 896 (1959). Cf. National Labor Relations Board v. Int'l Ass'n of Machinists, 263 F.2d 796, 798-99 (C.A. 9, 1959), certiorari denied, 362 U.S. 940 (1960); National Labor Relations Board v. Giustina Bros. Lumber Co., 253 F.2d 371, 374 (C.A. 9, 1958).

As the courts have consistently held, broker-dealer revocation recedings are remedial and not penal in nature. Their purpose is to recet the public from further violations rather than to punish an advidual for past misconduct. Berko v. Securities and Exchange Commission, 39/
F.2d 137, 141 (C.A. 2, 1963). Indeed, this is true of all civil proceedings are the antifraud provisions. As the Supreme Court said in Securities and change Commission v. Capital Gains Bureau, 375 U.S. 180, 195 (1963) (footnote atted), ". . . securities legislation 'enacted for the purpose of avoiding ruds,' [is to be construed] not technically and restrictively, but flexibly reffectuate its remedial purposes."

Petitioners concede that "the elements of common law fraud are not uired for securities misrepresentations . . . " (Br. 62). Furthermore, as so Court pointed out in Ellis v. Carter, 291 F.2d 270, 275 & n. 5 (1961), missal aff'd, 328 F.2d 573 (1964), Rule 9(b) of the Federal Rules of Civil cedure, which requires that fraud must be pleaded with particularity, is not licable to private actions under the antifraud provisions of the federal curities laws since a showing of common law fraud is not required. And, cofar as standard of proof is concerned, we know of no Commission enforcement ceeding or private action under the securities laws upholding the application

Accord, e.g., Pierce v. Securities and Exchange Commission, 239 F.2d 160, 163 (C.A. 9, 1956); Blaise, D'Antoni & Associates v. Securities and Exchange Commission, 289 F.2d 276, 277 (C.A. 5, 1961), rehearing denied per curiam, 290 F.2d 688, certiorari denied, 368 U.S. 899 (1961); Associated Sec. Corp. v. Securities and Exchange Commission, 283 F.2d 773, 775 (C.A. 10, 1960); Wright v. Securities and Exchange Commission, supra, 112 F.2d at 94 (C.A. 2, 1940) (expulsion from membership in national securities exchange).

of the high standard of proof sometimes imposed in cases in which common law frauches alleged.

In Securities and Exchange Commission v. Capital Gains Bureau, supra,

375 U.S. at 195, the Supreme Court, in dealing with the antifraud provisions of the Investment Advisers Act of 1940, noted:

[I]t would be logical to conclude that Congress codified the common law "remedially" as the courts had adapted it to the prevention of fraudulent securities transactions by fiduciaries, not "technically" as it has traditionally been applied in damage suits between parties to arm's-length transactions involving land and ordinary chattels. 42/

The rigorous requirements for the proof of common law fraud are not applicable when allegations are made that a fiduciary has not dealt properly with those to whom he owes his fiduciary duties. Indeed, in many such situations the burden of proof is actually shifted to the fiduciary, who must prove that transactions between them are in all respects fair. E.g., Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 599 (1921).

- 40/ In the panel decision of the Second Circuit in the Capital Gains case, 300 F.2d 745, 747 & n. 2 (1961), it was stated that fraud under the securities laws must be "established by 'clear and convincing' proof" (footnote omitted). This language was significantly deleted from the en banc decision of that court, 306 F.2d 606 (1962), which closely tracked the panel decision in most other respects and was itself reversed by the Supreme Court because of its narrow view of the statutory concept of fraud.
- 41/ 15 U.S.C. 80b-6. These provisions parallel the antifraud provisions of the Securities Act and the Exchange Act.
- 42/ Accord, e.g., Royal Air Properties, Inc. v. Smith, 312 F.2d 210 (C.A. 9, 1962)

 judgment for plaintiffs aff'd, 333 F.2d 568 (C.A. 9, 1964); Stevens v. Vowell,
 343 F.2d 374 (C.A. 10, 1965); Norris & Hirshberg v. Securities and Exchange

 Commission, 177 F.2d 228 (C.A. D.C., 1949); Charles Hughes & Co. v. Securities
 and Exchange Commission, 139 F.2d 434 (C.A. 2, 1943), certiorari denied, 321
 U.S. 786 (1944).
- 43/ See generally 24 Am. Jur. Fraud and Deceit \$ 258 (1st ed. 1939); 37 C.J.S. Fraud \$ 95 (1943); 9 Wigmore, Evidence \$ 2503 (3d ed. 1940).

The issue of the proper quantum of proof of fraud in broker-dealer poceedings before the Commission was recently considered in the case of the courties and Exchange Commission, C.A. 2, Docket No. 31469 (ct. 13, 1967). In that case the Commission had expressly held that the seponderance of the evidence was the appropriate standard of proof in such occedings. The court of appeals affirmed the Commission's decision for the bench without opinion. Thus the traditional "preponderance of the idence" standard applied in the great majority of civil cases was the propriate standard of proof in the proceedings before the Commission.

B. There Is Substantial Evidence to Support the Findings of Fraud and Manipulation.

The Commission found that Harrison and Magnuson made and caused ennaluna to make false and misleading statements and omissions of material act concerning the price of Silver Buckle stock, the desirability of West past as an investment and West Coast's financial condition (R. 4613-4619).

The Commission further found that these misrepresentations, coupled with ennaluna's bidding and trading in Silver Buckle stock commencing in October 1962 and it clear that Pennaluna and Harrison engaged in a manipulative scheme in the silver Buckle stock (R. 4613-4619), and that Magnuson was chargeable

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Securities Exchange Act Release No. 8090, at 5 (June 2, 1967). Accord, Underhill Sec. Corp., [1964-1966 Transfer Binder] CCH Fed. Sec. L. Rep. 177,270 (Aug. 3, 1965); Aviation Investors of America, 41 S.E.C. 566, 571 (1963); MacRobbins & Co., 40 S.E.C. 497, 505, remanded for further consideration sub nom. Kahn v. Securities and Exchange Commission, 297 F.2d 113 (C.A. 2, 1961), and Berko v. Securities and Exchange Commission, 297 F.2d 116 (C.A. 2, 1961), adhered to [1961-1964 Transfer Binder] CCH Fed. Sec. L. Rep. 176,853 (S.E.C., 1962), aff'd sub nom. Berko v. Securities and Exchange Commission, supra, 316 F.2d 137; White & Weld, 3 S.E.C. 466, 539-540 (1938).

with this manipulative conduct (R. 4617). The Commission also found that Pennaluna, Magnuson and Harrison violated Rule 10b-6 (R. 4619).

1. Misrepresentations and Omissions.

A recital of the statements involving misrepresentations and omissions is found at pp. 24-26, supra. In its release of Feb. 2, 1962, p. 44, supra, the Commission stated:

If . . . a dealer lacks essential information about the issuer, such as knowledge of its financial condition, he must disclose this lack of knowledge and caution customers as to the risk involved in purchasing the securities without it . . . The mere fact that a security may allegedly be exempt from the registration requirements of the Securities Act of 1933 does not relieve a dealer of these obligations. On the contrary, it may increase his responsibilities, since neither he nor his customers receive the protection which registration under the Securities Act is designed to provide. [emphasis added]

In addition, the Commission has repeatedly held that a broker-dealer $\frac{45}{45}$ must have a reasonable basis before making representations about a security. The Commission has also repeatedly held that predictions of specific and substantial increases in the price of a speculative security within a relatively short period of time are inherently fraudulent and cannot be justified, whether couched in terms of opinion or fact. Predictions need not be expressed in terms of a guarantee in order to be fraudulent. And the fact that a person is a sophisticated investor who usually deals in speculative securities and

^{45/} Lawrence, ['66-'67 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 77,424; (Dec. 30, 1966); MacRobbins & Co., Inc., supra n. 44.

^{46/} R. Baruch and Co., Securities Exchange Act Release No. 7932, p. 7 (August 9, 1966), CCH Fed. Sec. L. Rep., ¶ 68,169 (not reported in full).

^{47/} De Mammos, supra, note 44, p. 3.

ler to another.

knows that the security in question is speculative cannot excuse fraudulent

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resentations made to him. Although these rules have generally been developed reases involving broker-dealers and retail customers, the law is basically same in cases involving representations and price predictions made by one

The record shows and petitioners concede (p. 26, supra) that Harrison's presentations about Silver Buckle were based on rumors which he had heard im other brokers (R. 607), and that he had never seen any financial statements Silver Buckle or West Coast. Hence, Harrison's price predictions and false attements (pp. 24-26, supra) violated the antifruad provisions.

Petitioners urge, however, as they did in the proceeding below that rison's statements were merely permissible "chatter" between traders (Br. 46).

Commission rejected this argument, stating that "the other dealers placed $\frac{50}{}$ liance upon Harrison's statements" and that "the teletypes show that he reported to have and was looked to as a source of specific information regarding $\frac{51}{}$ condition and prospects of Silver Buckle" (R. 4616-4617). Under these

R. Baruch and Co., supra, p. 7; Floyd Earl O'Gorman, Securities Exchange Act Release No. 7959, pp. 3, 4 (Sept. 22, 1966), CCH Fed. Sec. L. Rep. p. 68,172 (not reported in full); R. A. Holman & Co., Inc., Securities Exchange Act Release No. 7770, p. 9 [1964-1966 Transfer Binder] CCH Fed. Sec. L. Rep. ¶77,313 (Dec. 15, 1965).

Van Alstyne, Noel & Co., 33 S.E.C. 311 (1952); Gearhart & Otis, Inc., Securities Exchange Act Release No. 7329, p. 23 (June 2, 1964), aff'd 348 F.2d 798 (C.A. D.C., 1965).

Reliance however is not an essential element in establishing a violation of the antifraud provisions. N. Sims Organ & Co., Inc., 40 S.E.C. 573, 575 (1961), aff'd 293 F.2d 78 (C.A. 2, 1961), cert. denied, 368 U.S. 968, (1962)

Petitioners contend that the term "inside" was used in the teletype conversations to refer to the inside, or wholesale price of Silver Buckle and not to "inside information" (Br. 68). But in response to a question from May & Co., "What is the inside on Silver Buckle?" (emphasis added). Harrison replied, "I just got a new Brokerage Information Sheet out on it giving full details" (R. 229). Hence Harrison interpreted the word "inside" to refer to information rather than to price.

circumstances, and in view of the fact that it was obvious to Harrison that the other dealers would pass the Silver Buckle stock on to their retail $\frac{52}{}$ customers, petitioners' argument concerning "broker's chatter" is without merit.

In any event, this argument of petitioners would, at most, only relate to the violations concerning the price predictions. It would have no bearing upon Harrison's false statements in the teletypes of December 10, 1962, and February 8, 1963. In the February teletype, in response to an inquiry from May & Co., "Are the West Coast people showing a profit each month?" Harrison replied, "Yes, and getting better everyday - every time they open up one [of] those deals its like making a new rich strike in a mine" (p. 25, supra). Harrison made this statement without having seen any West Coast financial statements. As set forth at pp. 9-11, supra, West Coast's operations were in fact losing money each month and all of the archery lanes were in financial trouble. And in the December teletype, Harrison falsely represented to May & Co. that all of the shares from the New Park-East Utah transaction were "off the market" and not for sale when he knew that Pennaluna had acquired 200,000 of the 800,000 shares not bought and retired by Silver Buckle in the transaction and that Pennaluna was actively selling these shares in the market.

^{52/} May & Co., for example, made sales to retail customers between October 5 and November 23, 1962 (R. 4322, 4324-4325).

Petitioners contend (Br. 69) that had Harrison seen West Coast's financial statements for the eleven months ended Jan. 31, 1963, he would have seen net earnings for that period and a reduced deficit. However, what petition fail to state, and what Harrison would have seen had he looked at the financial statements, was that the earnings resulted from the sale by West Coast of five of its six archery leases, so that West Coast in effect became a company without any operating assets but with a large deficit (see P. 11, supra).

^{54/} Page 25, supra.

^{55/ 25%} certainly cannot be deemed a "small percentage" (Br. 70).

The statements in these teletypes, and the failure of Harrison at any time to disclose that Pennaluna was selling large blocks of Silver Buckle on the market were clearly in violation of the antifraud provisions.

Petitioners assert that Silver Buckle stock "traded like a mining security" (Br. 70) and that therefore knowledge of the financial condition of the company was not relevant in making an investment decision. Initially, it should be pointed out that one of the prime functions of the securities laws is to promote full disclosure of information regarding companies whose shares are being publicly traded. One of the most important items of information is the financial condition of the company. Thus, petitioners' contention that in certain situations the broker-dealer may determine that financial information is not relevant would, if accepted, completely undermine one of the basic principles of the securities laws. Moreover, in the present case, a number of Harrison's teletype messages contained representations about the financial condition of West Coast. Harrison stated that West Coast's "archery business taking over like wildfire" (p. 25, supra). He also stated that West Coast was making a profit every month, and "getting better everyday" (p. 25, supra). To assert that knowledge of financial information was not relevant at a time when Harrison was making affirmative representation tations about the company's financial condition, is patently absurd.

2. Manipulation of the Market

The facts concerning Pennaluna's bidding and trading activity in Silver Buck stock following its commitment to purchase 200,000 shares of that stock are set for at pp. 19-23, supra. The Commission found that, "Pennaluna's bidding and trading. and its obvious motive for raising the price level," coupled with Harrison's misterpresentations and bullish price predictions, "make it clear that Pennaluna and

Harrison engaged in a manipulative scheme in the sale of [Silver Buckle] stock" $\frac{56}{}$ (R. 4614).

The Commission found that petitioners' activities had a manipulative purpose -- <u>i.e.</u>, that they were designed to raise the price of Silver Buckle stock artificially and to induce other broker-dealers to bid for that stock (R. 4613-4614). The Commission has long held that "since it is impossible to probe into the depths of a man's mind, it is necessary in the usual case that the finding of manipulative purpose be based on inferences drawn from circumstancial evidence."

Pennaluna's commitment in the New Park-East Utah transaction to acquire 200,000 shares of Silver Buckle stock gave Pennaluna a substantial incentive to raise the price of that stock. This incentive, viewed together with

Pennaluna's immediate commencement of activities likely to produce that rise, 58/provides ample evidence of a manipulative purpose. In addition, petitioners offer nothing of substance to avoid the inferences which must be drawn from Pennaluna's pricing activities. Pennaluna was consistently the high bidder

^{56/} Petitioners make several assertions (Br. 62-63) as to what the Commission did not find. With respect to the "nonfindings" numbered 1 and 4, neither domina tion of the market nor a special selling effort is a necessary element of a manipulative scheme. In any event, the Commission did find that from October to December 4, 1962, Pennaluna "did by far the greatest volume of trading in stock" (R. 4614). With respect to numbers 2 and 3, it is obvious that the Commission found the existence of an artificial market and that sales at what petitioners refer to as the "prevailing market" were sales at an artificial p

Federal Corp., 25 S.E.C. 227, 230 (1947). See Note, Regulation of Stock Market Manipulation, 56 Yale L.J. 509, 527 (1947).

^{58/} Federal Corp., 25 S.E.C. 227, 230 (1947); Thornton & Co., 28 S.E.C. 208 (1948 aff'd, Thornton v. Securities and Exchange Commission, 171 F.2d 702 (C.A. 2, 1948); Bruns, Nordeman & Co., 40 S.E.C. 652, 660 (1961). See generally, III Securities Regulation 1552-1553 (2d ed., 1961).

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in the sheets, and only two days after it had acquired 100,000 shares at 20 cents it raised its bid to 22 cents (3 cents higher than the next highest bidder). They offer no explanation of why they were "reaching" for those shares in their bidding when they had a large block available to them, nor of why they made purchases from other dealers and sold to retail customers at prices substantially lower than their bid in the sheets. The clear inference is that their bid was artificial and designed to mislead. These facts, and most significantly Harrison's unwarranted price predictions and assertions about Silver Buckle's prospects, fall precisely into the pattern of a typical manipulative campaign.

Notwithstanding the foregoing substantial evidence of manipulative purpose, petitioners argue (Br. 63-65) that the Commission has not shown a substantial relationship of "proximate cuase" between their actions and the increased market price of Silver Buckle. Petitioners assert that the substantial increase in the market price of Silver Buckle was caused solely by investor demand arising from publicity regarding West Coast's archery installations, and not by their own increased bidding and trading. Their own bidding and trading, they assert, was "normal" and "proper"—i.e., it was merely a response to and in no way a cause of the market in Silver Buckle. In effect, petitioners are arguing that the Commission could not weigh the potential market effect of their activities and

^{59/} See pp. 20-23, supra. Petitioners attempt to explain this (Br. 67) by pointing to the fact that on two days another firm exceeded Pennaluna's bid.

^{60/} The record indicates that on October 1, 1962, while bidding 22 cents in the sh Pennaluna purchased shares for as low as 18 1/2 cents and sold to retail customers for as low as 20 cents (see p. 20, supra).

conclude that, at least in part, those activities achieved the end which petitioners had every motive to attain.

Petitioners' argument, if accepted, would create a much more difficult evidentiary burden than was ever contemplated by Congress. Obviously, investor demand caused by publicity about a company is one of the many factors which may affect the market. Petitioners cannot, however, merely by asserting the presence of such investor demand, deny their own obvious effect upon the market. In view of the relatively slight market effect (R. 1892) caused by the "extensive publicity campaign" carried on prior to the commencement on October 1, 1962 of Pennaluna's increased activity (Br. 65) the Commission could properly conclude that Pennaluna's continually rising bids—and greatly increased trading activity "contributed substantially" to the activity in the market. As the court stated in Securities and Exchange Commission v. Torr, 22 F. Supp. 602, 608 (S.D. N.Y., 1938), in discussing the proof required to establish a manipulation,

It is extremely difficult to say that the massage of the market due to the activities of the defendants was the only reason why there was trading in Trans-Lux stock. All one can know is that the things above mentioned were done by these defendants, and that at once thereafter there was a noticeable increase in volume of trading in Trans-Lux stock and the rise in price expectable on such increased trading. These facts, coupled with the fact that the defendants . . . planned to make a profit on their option in the stock, are enough . . .

Moreover, petitioners' argument that it was the publicity concerning West

Coast which caused a rise in the price of the stock of Silver Buckle is contradicte

^{61/} It is well recognized that progressively rising bids are an indication of a manipulated market. See III Loss, Securities Regulation, 1564 (2d ed. 1961);
Collins v. United States, 157 F.2d 409, 410 (C.A. 9, 1946), Certiorari denied, 331 U.S. 859 (1947); Gob Shops of America, Inc., 39 S.E.C. 92, 101, (1959).

by a statement Harrison himself made. In his teletype to May & Co. on October

19, 1962, after the intensified bidding and trading activities in Silver Buckle had
been going on for over two weeks, Harrison stated that "... nobody knows that Silver Buckle owns West Coast" (R. 228). Thus, Harrison admitted that it could not have
been the publicity about West Coast which affected the market in Silver Buckle.

Finally, other statements made by Harrison in teletype conversations provide a strong indication that the market in Silver Buckle was being controlled or manipulated. On October 4, 1962, when the trader for May & Co. asked if he should "go long," Harrison replied: "I'll guarantee it. Don't want market up right now. Certain deals being signed between company and Steen, etc., but it will take off." On October 19, 1962, when the quotations had gone down temporarily and May & Co. inquired as to the reason, Harrison replied: "Salt Lake wants a low quote on it to justify their sale to Silver Buckle--so accommodating them--won't last long, couple days is all..." (See pp. 24-25, supra.) At the very least, these statements serve to refute petitioners' present argument that they had no influence on the market. Taken at their face value, the statements clearly indicate the existence 62/
of an artificial market and the presence of a manipulative scheme.

Although the evidence thus supports a finding of a causal relation between Pennaluna's activities and the rise in the general market price, we submit that proof of such a relation is not essential for the finding of a manipulative scheme. In our view, it is necessary to show only that an individual effected a series of transactions at progressively higher prices for the purpose of inducing others to purchase a security, not that the transactions caused a rise in the market. The only relevance of petitioners' assertion that there was investor demand is its bearing upon their purpose in effecting transactions at rising prices; and, as we have shown, there is ample evidence that their purpose was manipulative.

3. Bidding for and Purchasing Securities in Violation of Rule 10b-6.

Petitioners' challenge to the Commission's finding of violations of Rule 10b-6 rests upon the contention that Magnuson was not a controlling person of Silver Buckle. As we have shown, the Commission's finding of control is supported by substantial evidence, and accordingly the Commission properly found violations of Rule 10b-6.

- 4. Magnuson's Violations
- a. Magnuson is chargeable with Harrison's and Pennaluna's fraudulent and manipulative conduct. As the Commission stated (R. 4617), Magnuson

knew or should have been aware of Pennaluna's increased trading volume in Silver Buckle stock, the firm's increasing bids, the steadily rising price levels, and the incentive for raising the market price which existed by virtue of Pennaluna's ownership of 200,000 shares, an unusually large amount for Pennaluna to acquire at one time. Under these circumstances and by virtue of his position as a partner in Pennaluna and his substantial participation in the profits from the firm's trading in the stock of Silver Buckle as to which he was the partner most directly interested, Magnuson had a duty to keep himself apprised and provide appropriate restraints as to the manner in which such trading was being conducted. 63/ As an active major partner he had a duty to know of the nature and scope of the firm's activities, and being chargeable with knowledge, he must be held to have at least a shared responsibility for the violations which occurred.

b. Moreover, Magnuson himself sold large amounts of West Coast stock to persons other than Pennaluna during the period August 1963 through December 1963 without disclosing the adverse financial condition of West Coast, notwithstanding the fact that the existing public image of West Coast was that of highly successfuenterprise (see pp. 29-30, supra, and the Commissions opinion (R. 4617-18)).

^{63/} Cf. Alfred Miller, Securities Exchange Act Release No. 8012 (Dec. 28, 1966), p. 6; Thompson & Sloan, Inc., 40 S.E.C. 451, 457 (1961); John T. Pollard & C 38 B.E.C. 594, 598 (1958). [Footnote in original.]

Magnuson was a director and a controlling person of West Coast at this time,
and under principles now well established under the antifraud provisions of the
securities laws, he was under a duty in his securities transactions to disclose
material non-public information known to him by virtue of his position or, in
65/

the alternative, to forgo the transactions,

as the Commission stated (R. 4619):

Petitioners assert that Magnuson believed that "there was [a] tangible basis for optimism concerning the eventual financial success of West Coast" (Br. 73), that Magnuson had "canfidence in West Coast's future" (Br. 74-75) and that therefore Magnuson was not under a duty to disclose West Coast's adverse financial condition. It is clear, however, that by August 1963 there was no "tangible basis for optimism," and the Commission so found (R. 4618). Moreover, the theory behind the disclosure requirements is that both the insider and the other party to a securities transaction should be able to base their investment decision on the same material information. Hence, assuming arguendo that there was a tangible basis for Magnuson's optimistic beliefs, he would still have had the duty, as an insider, to disclose the then existing adverse financial condition of West Coast to the purchasers of his West Coast stock, so that they could make their own informed decision as to the desirability of investing in the company. This is particularly true in light of the fact that West Coast's favorable public image

- . . . when the company's actual condition had to Magnuson's knowledge become radically different from the favorable image
- 64/ Petitioners admit Magnuson's control position when they admit that his sales of West Coast stock constituted a violation of Section 5 of the Securities Act (Br. 74).

was one which Magnuson himself had helped create (pp. 29-30, supra). Accordingly,

- Securities and Exchange Commission v. Texas Gulf Sulphur, 258 F. Supp. 262
 (S.B.N.Y., 1966) appeal pending; List v. Fashion Park, Inc., 340 F. 2d 457,
 461-62 (C.A. 2), cert. denied, 382 U.S. 811 (1965); Cady, Roberts & Co., 40
- S.E.C. 907 (1961).

 66/
 The fact that "the financial condition of the company was complex" (Br. 74) heightened rather than diminished Magnuson's duty to disclose.

that he knew of and had himself fostered, it was improper for him to sell his shares without disclosure of the grave financial problems facing West Coast.

III. PETITIONERS' OBJECTIONS TO THE CONDUCT OF THE COMMISSION'S STAFF
ARE UNTIMELY AND IN ANY EVENT ARE WITHOUT MERIT.

Petitioners raise a number of objections based upon alleged misconduct of the Commission's Division of Trading and Markets in the proceeding below (Br. 75-77). Since these objections were never urged before the Commission, petitioners are precluded, under Section 25(a) of the Exchange Act, from urging $\frac{68}{}$ them on this review. In any event, petitioners' objections are without merit.

67/ Petitioners assert (Br. 77) that "[a]11 of these matters were brought to the attention of respondent [Commission] prior to filing this petition for review" (emphasis added). The only support offered for this assertion is a reference to a document (Supp. R. 4690-4698) entitled Petition and Motion For Further Rehearing, Reconsideration and Review, which was delivered to the Commission's Office of the General Counsel on September 5, 1967 after the filing of their petition for review in this Court (September 1, 1967). That document was forwarded by the Office of the General Counsel to the Secretary of the Commission who refused to accept it for filing "since it was received long [131 days] after the 10-day limit for filing a petition for rehearing pursuant to Rule 21(e) of the Commission's rules of practice had expired" (Supp. R. 4698). Petitioners offered no reason for the untimeliness of their petition It should be noted in this connection that an earlier petition for rehearing and reconsideration was considered by the Commission even though it too was untimely, having been filed 18 days beyond the time permitted by the rule (R. 4631).

In any event, the petition which was not accepted for filing (Supp. R. 4690-4698) raised only one of the objections made here (i.e., that petitioners were not advised of the degree of sanction being sought by the Division) and we have been unable to find anything elsewhere in the record indicating that petitioners ever raised any of their other objections befor the Commission.

68/ See p. 46 and note 38, supra.

Petitioners assert (Br. 76) that they waived their right to a hearing and proceeded by way of stipulation directly to oral argument before the Commission "without being advised that revocation and bar was being sought" by the Division. In addition, they appear to be arguing that the Division misled them into believing that after the completion of a stipulation the Division would accept an offer of settlement providing for only a suspension rather than revocation and There is no support for these contentions and in fact the record indicates the opposite of what they contend. The Division's initial brief (R. 3639-3984), filed with the Commission in September 1965, only three months after completion of the stipulation urged the Commission to impose sanctions of revocation and bar. The Division's reply brief (R. 4424-4473), filed in February 1966, reaffirmed this position. Under these circumstances, it is difficult to understand how petitioners can argue that the Division was "inferring" to them that it was rejecting settlement offers only because it "desired the respondent [Commission] to set the number of days and suspension terms" (Br. 76). The claim that petitioners were misled by the Division should be viewed in the light of the fact that throughou the proceeding while the Division was urging the sanctions of revocation and bar, petitioners gave absolutely no indication that they felt they were being misled by the Division. The contention that they were misled is simply an afterthought.

^{69/} It should be noted, of course, that it is the Commission and not its Division of Trading and Markets which determines whether an offer of settlement will be accepted. See Rule 8(a) of the Commission's Rules of Practice, 17 CFR 201.8(a)

Petitioners offer only two concrete facts. First, they quote from a letter dated February 22, 1965 which, in addition to the fact that it is not a part of the record, says nothing more than that the Division expected petitioners to make an offer of settlement (not that such an offer would be accepted by the Division, let alone the Commission). Second, they point to their settlement offer of July 18, 1966, which the Division considered unacceptable. This offer was made only one week prior to oral argument before the Commission.

^{71/} This connection was first raised in the petition for further rehearing which petitioners attempted to file some four months after the issuance of the Commission's order of revocation. See note 67, supra.

With respect to the claim that the Division took the testimony of

Anthony Vaghi without notice to petitioners' counsel (Br. 76-77), petitioners

fail to state in their brief that Vaghi's testimony was included in the record

by way of stipulation between themselves and the Commission's staff (R. 4226-4227)

Petitioners offer no reason why they did not request an opportunity to cross-examination of the testimony in the stipulation. Indeed, petitioners raised no

objection to the Division's action until their brief was filed in this review pro
72/

ceeding and have never requested an opportunity to cross-examine Vaghi.

Finally, with respect to petitioners' other objections (Br. 77), Division counsel did not go beyond the scope of the stipulation in oral argument before the Commission, and petitioners' "belief" that memoranda concerning Harrison were submitted ex parte to the Commission by the Division is without record suppor

IV. THE SANCTIONS IMPOSED BY THE COMMISSION WERE WELL WITHIN ITS DISCRETIONARY AUTHORITY.

Petitioners argue (Br. 78) that the Commission failed to consider or proper evaluate certain factors in making the statutory determination of what sanctions should be imposed in the "public interest." Quite to the contrary, it is clear from the Commission's opinion (R. 4608-4621) and from the Commission's order denyi

^{72/} Vaghi's testimony was taken only after petitioners had obtained an affidavit from him and had requested that the affidavit be placed in a supplemental stipulation (R. 4310-13). Moreover, contrary to the implication in petition brief (Br. 77), Vaghi was advised of his right to be represented by counsel stated that he wished to proceed without counsel (R. 4478).

^{73/} Even if petitioners were correct in asserting (Br. 71) that commsel for the Division had wrongly implied that Harrison knew certain adverse information about Silver Buckle and West Coast, it is clear, in any event, that Harrison was not prejudiced, since the Commission's finding of antifraud violations by him did not depend on his possession of adverse information. See pp. 49-58, supra.

registed each of the factors which petitioners assert were not considered. In its opinion, the Commission, after setting forth the factors which petitioners had bresented as bearing upon the public interest, stated (R. 4621):

[T]he factors referred to by respondents cannot overcome the serious nature of the violations we have found. In view of these violations, we conclude that it is in the public interest to bar Harrison and Magnuson . . . , to expel Harrison from membership in the Spokane Stock Exchange, and . . . to revoke registrant's broker-dealer registration.

In its order denying the petition for reconsideration, the Commission concluded that '[i]n view of the serious violations . . . found, . . . the additional material submitted by petitioners did not warrant a modification of the sanctions imposed."

As this Court noted only a year ago in reviewing another Commission order entered under the Exchange Act:

Where the established facts empower an administrative agency to take particular remedial action, the determination of whether it should take that action rests within the sound discretion of the agency. $\overline{75}$

- Insofar as petitioners refer to pages 4671 to 4689 of their Supplemental Record as material which should have been considered by the Commission, none of this material was ever submitted by them to the Commission. Included in this material are two letters from Bernard G. Lonctot to Commissioner Owens, dated May 27, 1966 (Supp. R. 4678-4680) and March 5, 1965 (Supp. R. 4687-4689), but those letters were ex parte communications and under the Commission's rules concerning such communications could not be considered in the proceeding. (See Section 200.111 of the Commission's Code of Behavior Governing Ex Parte Communications, 17 CFR 200.111.)
 - San Francisco Mining Exchange v. Securities and Exchange Commission, 378 F. 2d 162, 165 (1967) (citing Consolo v. Federal Maritime Commission, 383 U.S. 607, 620-621; Securities and Exchange Commission v. Chenery Corp., 332 U.S. 194, 208; American Power & Light Co. v. Securities and Exchange Commission, 329 U.S. 90, 112-113). The Commission's order in the Mining Exchange case withdrethe registration of a national securities exchange.

It was also stated in the Mining Exchange case, 378 F. 2d at 165, that the Commission "was not required to accord controlling weight to testimonials" which concerned the "desirability of continuing the Exchange in operation" but which "did not, in the main, deal with the merits of the case. . . "

Similarly, in <u>Pierce</u> v. <u>Securities and Exchange Commission</u>, 239 F.2d 160 (1956), this Court stated, <u>id</u>. at 163:

. . . The Commission is given the duty to protect the public. What will protect the public must involve, of necessity, an exercise of discretionary determination. This Court ordinarily should not substitute its judgment of what would be appropriate under the circumstances in place of the Commission's judgment as to measures necessary to protect the public interest. . . . 76/

In view of the numerous and serious violations by petitioners of the registration and antifraud provisions, as well as their violations of various other provisions of the securities laws, the sanctions imposed by the Commission were well within its discretionary authority.

Accord, Tager v. Securities and Exchange Commission, 344 F.2d 5, 8-9 (C.A. 2 1965); Berko v. Securities and Exchange Commission, 316 F.2d 137, 141-142 (C.A. 2, 1963); Wright v. Securities and Exchange Commission, 112 F.2d 89, 95-96 (C.A. 2, 1940); cf. Marketlines, Inc. v. Securities and Exchange Commission, 384 F.2d 264, 267 (C.A. 2, 1967), certiorari denied, 36 U.S.L.W. 3343 (March 4, 1968).

CONCLUSION

For the foregoing reasons the orders of the Commission should be affirmed.

Respectfully submitted,

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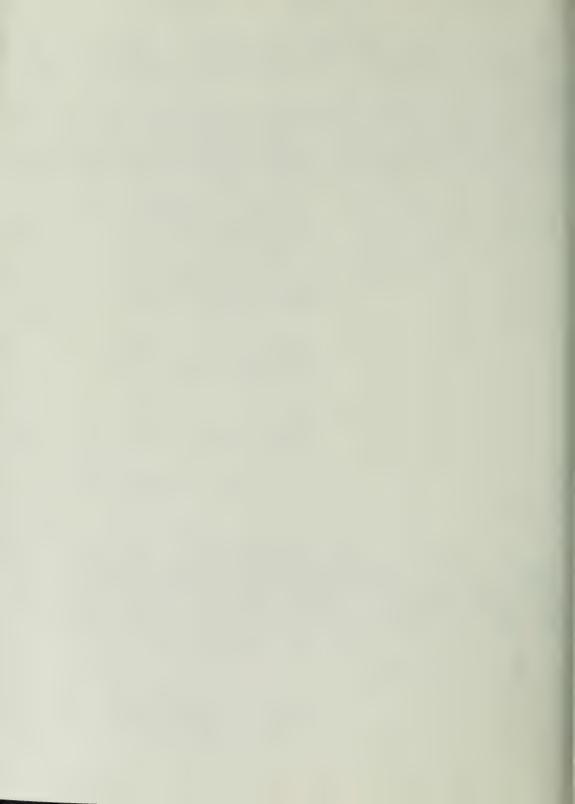
June 1968

CERT IF ICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Jacob H. Stillman

Assistant General Counsel







curities Act:

Definitions

Sec. 2. When used in this title, unless the cont otherwise requires-

(2) The term "person" means an individual, a rporation, a partnership, an association, a jointock company, a trust, any unincorporated ornization, or a government or political subdivion thereof. As used in this paragraph the term rust" shall include only a trust where the interest interests of the beneficiary or beneficiaries are idenced by a security.

(11) The term "underwriter" means any pern who has purchased from an issuer with a view , or offers or sells for an issuer in connection th, the distribution of any security, or particites or has a direct or indirect participation in y such undertaking, or participates or has a parcipation in the direct or indirect underwriting any such undertaking; but such term shall not clude a person whose interest is limited to a mmission from an underwriter or dealer not excess of the usual and customary distributors' sellers' commission. As used in this paragraph e term "issuer" shall include, in addition to an suer, any person directly or indirectly controlng or controlled by the issuer, or any person nder direct or indirect common control with the suer.

Exempted Transactions

SEC. 4. The provisions of section 5 shall not

pply to— (1) transactions by any person other than an

suer, underwriter, or dealer.

(2) transactions by an issuer not involving

ny public offering.

(3) transactions by a dealer (including an nderwriter no longer acting as an underwriter respect of the security involved in such transction), except—

(A) transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter,

(B) transactions in a security as to which a registration statement has been filed taking place prior to the expiration of forty days after the effective date of such registration statement or prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter after such effective date, whichever is later (excluding in the computation of such forty days any time during which a stop order issued under section 8 is in effect as to the security), or such shorter period as the Commission may specify by rules and regulations or order,

(C) transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of such securities by the issuer or by or through an underwriter. With respect to transactions referred to in clause (B), if securities of the issuer have not previously been sold pursuant to an earlier effective regis-

tration statement the applicable period, instead of

forty days, shall be ninety days, or such shorter period as the Commission may specify by rules and regulations or order.

(4) brokers' transactions executed upon customers' orders on any exchange or in the overthe-counter market but not the solicitation of such

orders.

Prohibitions Relating to Interstate Commerce and the Mails

SEC. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any

person, directly or indirectly-

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for

delivery after sale.

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8.

Fraudulent Interstate Transactions

Sec. 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly-

(1) to employ any device, scheme, or arti-

fice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the pur-

chaser.

Rules Under the Securities Act:

Rule 405 Definitions of Terms

Unless the context otherwise requires, all ter used in this regulation or in the forms for retration have the same meanings as in the Acta in the General Rules and Regulations. In ad tion, the following definitions apply, unless context otherwise requires:

Control.—The term "control" (including terms "controlling," "controlled by" and "md common control with") means the possession of rect or indirect, of the power to direct or can the direction of the management and policies a person, whether through the ownership voting securities, by contract, or otherwise.

Exchange Act:

Definitions and Application of Title

SECTION 3. (a) When used in this title, unless the context otherwise requires-

(18) The term "person associated with a brote: or dealer" means any partner, officer, director, of branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such brokera dealer, including any employee of such broker or dealer, except that for the purposes of section 15(b) of this title (other than paragraph (thereof), persons associated with a broker or dealer whose functions are clerical or ministerial shall me be included in the meaning of such term. The Commission may by rules and regulations classify. for the purpose of any portion or portions of the title, persons, including employees, controlled by a broker or a dealer.

rohibition Against Manipulation of Security Prices

non 9. (a) It shall be unlawful for any directly or indirectly, by the use of the or any means or instrumentality of inter-ommerce, or of any facility of any national ies exchange, or for any member of a nasecurities exchange—

* * *

To effect, alone or with one or more other s, a series of transactions in any security ered on a national securities exchange creactual or apparent active trading in such ty or raising or depressing the price of such ty, for the purpose of inducing the purchase of such security by others.

* * *

ation of the Use of Manipulative and Deceptive Devices

rion 10. It shall be unlawful for any person, by or indirectly, by the use of any means or mentality of interstate commerce or of the or of any facility of any national securities

To effect a short sale, or to use or employ op-loss order in connection with the purchase e, of any security registered on a national ties exchange, in contravention of such rules egulations as the Commission may prescribe essary or appropriate in the public interest

the protection of investors.

To use or employ, in connection with the lase or sale of any security registered on a hal securities exchange or any security not so ered, any manipulative or deceptive device or ivance in contravention of such rules and ations as the Commission may prescribe as sary or appropriate in the public interest or as protection of investors.

Over-the-Counter Markets

Section 15. (a) (1) No broker or dealer (other than one whose business is exclusively intrastate) shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, unless such broker or dealer is registered in accordance with subsection (b) of this section.

* * *

(b) (1) A broker or dealer may be registered for the purposes of this section by filing with the Commission an application for registration, which shall contain such information in such detail as to such broker or dealer and any persons associated with such broker or dealer as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine.

4 4 4

(5) The Commission shall, after appropriate notice and opportunity for hearing, by order censure, deny registration to, suspend for a period not exceeding twelve months, or revoke the registration of, any broker or dealer if it finds that such censure, denial, suspension, or revocation is in the public interest and that such broker or dealer, whether prior or subsequent to becoming such, or any person associated with such broker or dealer, whether prior or subsequent to becoming so associated—

* * *

- (D) has willfully violated any provision of the Securities Act of 1933, or of the Investment Advisers Act of 1940, or of the Investment Company Act of 1940, or of this title, or of any rule or regulation under any of such statutes.
- (E) has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of the Securities Act of 1933, or the Investment Advisers Act of 1940, or the Investment Company Act of 1940, or of this title, or of any rule or regulation under any of such statutes or has failed reasonably to supervise, with a view to preventing violations of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the purposes of this clause (E) no person shall be deemed to have failed reasonably to supervise any person, if—

(i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such

other person, and

(ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

(F) is subject to an order of the Commission entered pursuant to paragraph (7) of this subsection (b) barring or suspending the right of such person to be associated with a broker or dealer, which order is in effect with respect to such person.

* * *

(7) The Commission may, after appropriate notice and opportunity for hearing, by order censure any person, or bar or suspend for a period not exceeding twelve months any person from being associated with a broker or dealer, if the Commission finds that such censure, barring, or suspension is in the public interest and that such person has committed or omitted any act or omission enumerated in clause (A), (D) or (E) of paragraph (5) of this subsection or has been convicted of any offense specified in clause (B) of said paragraph (5) within ten years of the commencement of the proceedings under this paragraph or is enjoined from any action, conduct, or practice specified in clause (C) of said paragraph (5). It shall be unlawful for any person as to whom such an order barring or suspending him from being associated with a broker or dealer is in effect, willfully to become, or to be, associated with a broker or dealer, without the consent of the Commission, and it shall be unlawful for any broker or dealer to permit such a person to become, or remain, a person associated with him, without the consent of the Commission, if such broker or dealer knew, or in the exercise of reasonable care, should have known, of such order.

* * *

(1) (1) No broker or dealer shall make use of chails or of any means or instrumentality of treate commerce to effect any transaction in, or nduce the purchase or sale of, any security for than commercial paper, bankers' acceptas, or commercial bills) otherwise than on a conal securities exchange, by means of any sipulative, deceptive, or other fraudulent device contrivance. The Commission shall, for the coses of this subsection, by rules and regulase define such devices or contrivances as are ipulative, deceptive, or otherwise fraudulent.

Powers With Respect to Exchanges and Securities

its opinion such action is necessary or appriate for the protection of investors—

* * *

hearing, by order to suspend for a period not eding twelve months or to expel from a naul securities exchange any member or officer eof whom the Commission finds has violated provision of this title or the rules and regulathereunder, or has affected any transaction any other person who, he has reason to be, is violating in respect of such transaction provision of this title or the rules and regulathereunder.

Court Review of Orders

ection 25. (a) Any person aggrieved by an er issued by the Commission in a proceeding er this title to which such person is a party obtain a review of such order in the Court of reals of the United States, within any circuit rein such person resides or has his principal to of business, or in the United States Court appeals for the District of Columbia, by filing such court, within sixty days after the entry of a order, a written petition praying that the er of the Commission be modified or set aside whole or in part. A copy of such petition shall forthwith transmitted by the clerk of the court

to any member of the Commission, and thereupon the Commission shall file in the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record shall be exclusive, to affirm, modify, and enforce or set aside such order, in whole or in part.3 No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts, by reason of the additional evidence so taken, and it shall file such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, and enforcing or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347).

Rules Under the Exchange Act:

Rule 10b-5. Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate

as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Rule 10b-6. Prohibitions Against Trading by Persons Interested in a Distribution

(a) It shall constitute a "manipulative or deceptive device or contrivance" as used in section 10(b) of the Act for any person,

(1) who is an underwriter or prospective underwriter in a particular distribution of securities,

(2) who is the issuer or other person on whose behalf such a distribution is being made, or

(3) who is a broker, dealer, or other person who has agreed to participate or is participating in such a distribution, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, either alone or with one or more other persons, to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution, or any security of the same class and series, or any right to purchase any such security, or to attempt to induce any person to purchase any such security or right until after he has completed his participation in such distribution:

Rule 15c1-2. Fraud and Misrepresentation

(a) The term "manipulative, deceptive, other fraudulent device or contrivance," as u in section 15(c)(1) of the Act, is hereby defito include any act, practice, or course of busin which operates or would operate as a fraud deceit upon any person.

(b) The term "manipulative, deceptive, other fraudulent device or contrivance," as u in section 15(c)(1) of the Act, is hereby defi to include any untrue statement of a material: and any omission to state a material fact necess in order to make the statements made, in the li of the circumstances under which they are m not misleading, which statement or omission made with knowledge or reasonable grounds to lieve that it is untrue or misleading.

(c) The scope of this rule shall not be ited by any specific definitions of the term "ma ulative, deceptive, or other fraudulent devic contrivance" contained in other rules ado

pursuant to section 15(c)(1) of the Act.

Code of Behavior Governing Ex Part Communications Between Persons Outside the Commission and Decisio Employees:

Applicat 200.111 Prohibitions; Section Definitions; Limitations.

(a) Except as set forth in Section 200.11 hereof, no person who is not an employee of Commission should make any unauthorize parte communication directly or indirectly a an on-the-record proceeding to any Commi member or decisional employee or solicit any person to make an ex parte communication v the solicitor has reason to know is unauthor nor should any Commission member or decis employee in a proceeding request or consider unauthorized ex parte communication.

United States Court of Appeals

For the Ninth Circuit

PENNALUNA & COMPANY, INC. BENJAMIN A. HARRISON, and HARRY F. MAGNUSON,

AUL AND

Petitioners,

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SECURITIES EXCHANGE COMMISSION,

Respondent.

PETITION FOR REVIEW OF ORDER OF SECURITIES EXCHANGE COMMISSION

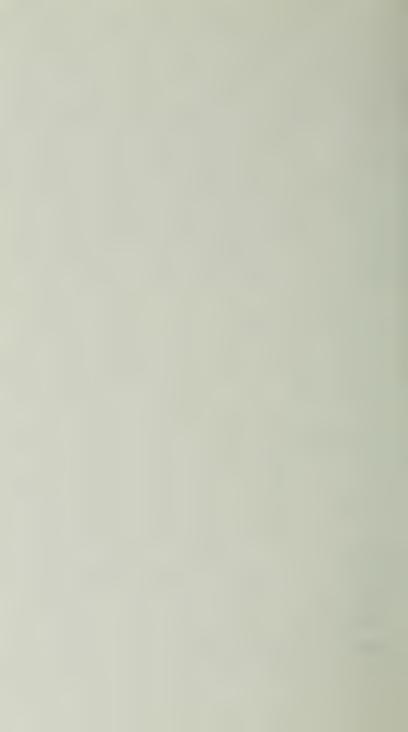
REPLY BRIEF OF PETITIONERS
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United States Court of Appeals For the Ninth Circuit

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V

SECURITIES EXCHANGE COMMISSION,

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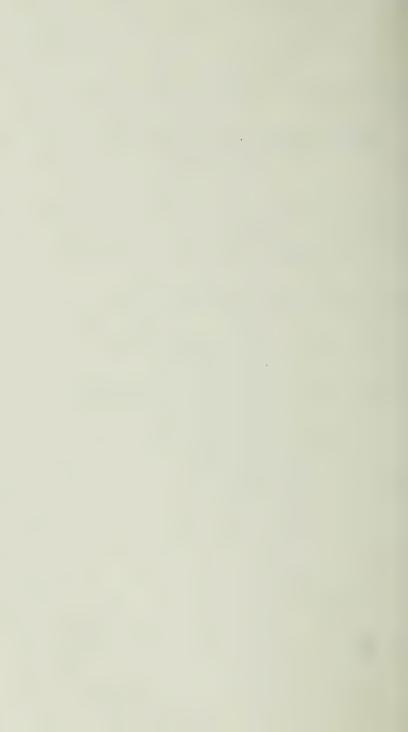
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United States Court of Appeals

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BENJAMIN A. HARRISON and
HARRY F. MAGNUSON

The respondent's brief (hereinafter referred to as Resp. Br.) fails almost completely to understand and meet the questions of law and fact raised in the petitioners opening brief (hereinafter cited as Br.). Petitioners will reply to the basic errors of that brief and to respondent's improper use of unfounded inferences and emphasize significant admissions. For

clarity, the headings of petitioners opening brief will be used wherever possible, with direct citation to the relevant page of respondent's brief.

I.

THE RESPONDENT'S STATEMENT OF THE CASE MISCONSTRUES RELEVANT FACTS AND OBSCURES CRITICAL DETAILS, ALL IN COMPLETE DISREGARD OF BOTH ITS RESPONSIBILITY AS A GOVERNMENT AGENCY AND ITS OBLIGATIONS TO THIS COURT.

The respondent neither accepts nor rejects petitioners carefully documented statement of the case. The respondent colorfully describes the background of this case and blatantly argues and editorializes in selected areas without regard for the fact finding and disclosure obligations of a government agency. The petitioners will not refute each misstatement and improper factual inference, as the direct reply is contained, whenever necessary, in the opening brief or in the additional argument contained herein. Singularly appropriate examples, however, will be set forth to emphasize the respondent's lack of elementary good faith, illustrative of the abuse of the administrative process that has characterized the entire proceeding.

The respondent infers in its statement of the case that Dr. F. E. Scott arranged a deal with Robert Cranmer, the president of Oil, Inc., for the purchase of Silver Buckle shares owned by that company solely for the purpose of protecting Silver Buckle from the undeclared grasp of Steen. (Resp. Br. 16; Resp. Br. 42). Not only is there no support for this inference but the motive of Scott, whatever it might have been, is completely irrelevant. Whether or not the shares acquired by Magnuson required registration — an issue not based upon motive — is the only question raised by that transaction. The prejudicial impact of such improper inferences obviously is difficult to combat.

The respondent recites the bidding activity of Pennaluna from September, 1962 forward without setting forth the comparable activity of other brokers, even though this information is found in the Record. (Resp. Br. 19-23). A portion of the chart prepared by respondent's Division of Trading and Markets (hereinafter referred to as the Division) has been set forth at pages 1 to 8 of the Appendix to this Brief. This Court can examine the trading pattern of Pennaluna and other brokers and determine if an inference of any conduct other than normal market activity would be justified. The response of 32 brokers actively purchasing and selling Silver Buckle shares to the impact of the admittedly extensive publicity, which the respondent disapproves but for which petitioners, even allegedly, were not responsible, is the only reliable guide for this Court.

^{1.} See, e.g., implied criticism of West Coast annual report (Resp. Br. 29). Respondent does not point out that petitioners had nothing to do with its preparation or dissemination of any of the information contained therein. (Resp. Br. 29).

Irrelevant footnotes of fact and improper statutory references are scattered throughout the statement of the case and the argument, obviously designed to make prejudicial impressions. For instance, the respondent states, in a footnote, that the office of L. E. Nicholls & Company adjoined that of Pennaluna, inferring that an equal bid submitted by Nicholls was not independently made. (Resp. Br. 23).² The respondent refers to Section 9 of the Securities Exchange Act (15 U.S.C. 78i) (Resp. Br. 4). Since the petitioners were not charged with violating its provisions, further reference to it is not made by respondent in its argument. It should not be before this Court.

The Commission's opinion did not set forth specific findings of fact, and failed to rule upon the materiality of evidence in the Record and inferences outside the Record. Consequently, the respondent is able to pour forth the irrelevant and improper inferences developed by the Division without restraint. The continuing objection to irrelevant and immaterial matters guaranteed to the petitioners in the stipulation has been completely ignored by all those charged with a fact finding obligation. (R. 443). Respondent's statement of the case effectively illustrates the abuse to which petitioners referred in their opening brief. (Br. 75-77).

^{2.} The inferential arguments and irrelevant facts were developed for the respondent in the Division's brief. The location of L. E. Nicholls' office is first mentioned in a footnote in the Division's brief. (R. 3799). Consequently, the Commission could have stopped this prejudicial approach, but chose instead to make no rulings whatever on the materiality or probative value of matters in and out of the Record.

II.

THE RESPONDENT'S FINDING THAT THE SILVER BUCKLE
SHARES PURCHASED AND SOLD DURING 1962 AND 1963
BY PETITIONERS REQUIRED REGISTRATION UNDER
SECTION 5 OF THE SECURITIES ACT (15 U.S.C. 77e)
IS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE
(BR. 47-59).

A. The respondent required petitioners to establish an exemption from registration; under the circumstances of this case, placing the burden of proof upon petitioners constitutes an abuse of administrative due process of law.

The respondent admits that Section 7(d) of the Administrative Procedure Act, (5 U.S.C. 556(d)) applies to an administrative proceeding of this type. The respondent's argument that the Securities Act falls within the clause stating "except as otherwise provided by statute" is amazingly brief and completely lacking in authority. (Resp. Br. 36). Doesn't the "traditional allocation of the burden of proof" require the moving party to establish the validity of his contention? The Division was the proponent of the order; that it frequently shifted position shows that the burden weighed heavily upon it.³

Petitioners submit that the respondent had the burden of establishing that an "issuer," as defined by Section 2(11) of the Securities Act (15 U.S.C. 77(b)

^{3.} The Division's changing theory of control is diagrammed in the petitioners' supplemental brief filed before the Commission and in the opening brief before this Court. (R. 4516; Br. 49). The Division maintained, under one theory, that Magnuson and a group including Scott were in control of Silver Buckle (R. 3920-3928); respondent does not answer petitioners' statement that the finding that only Scott and Magnuson were in control was a new theory, not contended for by the Division. (Br. 50 and Br. App. 112; Resp. Br. 37).

(11)), was present in each transaction; it is this burden of proof of fact — whether a 2(11) issuer (i.e. a controlling person) was present — that is the proper question before this Court. Until an "issuer" is found, the so-called "long line of authorities" cited by the respondent are not relevant. (Resp. Br. 35). In fact, the respondent admits that S.E.C. v. Ralston Puring, 346 U.S. 119 (1953) does not reach this guestion. A burden of proof should shift to a defendant in an administrative proceeding only when a presumption under law has been shown. Section 5 (15 U.S.C. 77e) does not presumptively apply unless an issuer is present. Section 7(d) of the Administrative Procedure Act (5 U.S.C. 556(d)) and basic concepts of administrative due process require the respondent, now as the proponent, to carry factual burdens when alleging a need for registration under Section 5 (15 U.S.C. 77e).

B. The "whole record" does not support the respondent's finding that Magnuson was a member of a control group during the entire period under review; the respondent further has failed to make responsible, specific findings.

The issue is whether there is substantial evidence to support the Commission's finding that Pennaluna sold for or on behalf of a controlling person of the issuer (R. 4612 and Br. App. 112). The issue is not whether "Harrison knew or should have known that distributions of control stock were taking place." (Resp. Br. 44). Respondent's twist of the issue attempts to diminish the degree of substantial evidence which this Court must find in the whole Record.

The respondent's brief admits clearly (and clarifies the Commission's opinion) that Pennaluna (through Harrison) purchased its shares directly from Oil, Inc. and New Park-East Utah (rather than circuitously through Magnuson as the Division had contended) and that those shares did not require registration. (Resp. Br. 43-46). Since Magnuson did not sell his Silver Buckle shares through Pennaluna, (with the exception of his 37½ percent interest in the so-called O'Brien transaction during May-June, 1963) Pennaluna and Harrison allegedly violated Section 5, not because of their own transactions, but because they are charged, almost as a matter of law, with a responsibility for Magnuson's personal, independent transactions.

Pennaluna did not sell "for" Magnuson; respondent, therefore, must show wherein Pennaluna sold "on behalf of" Magnuson. An underwriter, as defined by Section 2(11) of the Securities Act (15 U.S.C. 77(b) (11)) does not include one who simply sells "on behalf of" a controlling person (issuer) when the shares involved have not been purchased from the controlling person (issuer). The Commission's finding, even if supportable, is beyond the scope of the statute. The respondent must be required to establish a legal and factual basis for the Commission's conclusion.

The transactions in which Magnuson acquired his shares of Silver Buckle are described at pages 13-21 and 51-59 of petitioners' opening brief. That the Commission should have made specific findings for each transaction, rather than using events occurring in

December, 1962 to support a control status in May, 1962, is admitted by the respondent. (Resp. Br. 43-44).

The "substantial evidence" which this Court must find in the Record to support the respondent's opinion has been defined as follows in *Consolo v. Federal Maritime Commission*, 383 U.S. 607, 619 (1966):

"We have defined 'substantial evidence' as 'such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." Consolidated Edison Co. v. Labor Board, 305 U.S. 197, 229, 83 L.Ed. 126, 140, 59 S. Ct. 206. '[I]t must be enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury."

The series of irrelevant and extraneous facts recited by the respondent is not "relevant evidence." (Resp. Br. 40-44). The Commission, in fact, did not base its conclusion upon these facts. The respondent asks this Court to affirm the Commission's finding and opinion by the use of facts which the Commission itself may have found to be immaterial and irrelevant. Again,

^{4.} The respondent's brief refers to the fact that Magnuson was a director of Vindicator Silver-Lead Mining Company, a company in which Dr. F. E. Scott was also a director. (Resp. Br. 41). Harry F. Magnuson became an officer of Vindicator in 1949, approximately four years before Vindicator and Silver Buckle executed a working agreement for the Vindicator property. (R. 4084). He became a director on June 6, 1960, at the request of Mr. Walter Logus, the president of Vindicator, to assist him in resolving a dispute that had arisen between Dr. Scott and Mr. Logus. (R. 4084). This dispute was quite heated and Magnuson, at all times, represented Mr. Logus' interests. (R. 4102; R.4103). It was stipulated that Magnuson did not participate in any negotiation concerning the Vindicator-Silver Buckle agreement in 1953. (R. 161). The agreement was terminated by action of the shareholders of both companies during January, 1968.

the continuing but, at this point, undecided objection to the use of immaterial and irrelevant evidence, has critical significance. (R. 443).

Whether or not the petitioner Magnuson is a controlling person effects the following issues:

- (1) The status of his sales of Silver Buckle stock;
- (2) The responsibility of petitioners Pennaluna and Harrison for those transactions;
- (3) The scope of Harrison's duty and responsibility to other dealers in the wholesale market;
- (4) The presence or absence of a distribution within the concept of Rule 10b-6 (17 CFR 240.10b-6).

In the Matter of S. T. Jackson, Inc. et al, 36 S.E.C. 631 (1950) established definite criteria by which to determine the presence of a control group. The allegedly determinative facts recited by the respondent do not even approach the degree of close business and personal relationship found in that case. To rest serious and grave charges upon such a flimsy foundation is a shocking abuse of the administrative process.

111.

PETITIONERS PENNALUNA AND HARRISON DID NOT VIOLATE THE PROVISIONS OF RULE 10b-6, AS A MATTER OF LAW. (BR. 59).

The respondent accepts the petitioners' contention that a violation of Rule 10b-6 is present only if Magnuson is a controlling person. (Resp. Br. 58). Further, the respondent admits that Pennaluna purchased shares of Silver Buckle directly from Oil, Inc. and from New Park-East Utah, and that these shares did not require registration. (Resp. Br. 43-46). The Commission did not establish any other basis for a distribution, within the meaning of the rule, other than the technical distribution requiring registration under Section 5. (R. 4619; Br. App. 119). Since Pennaluna and Harrison were not selling (i.e., distributing) shares which required registration, Pennaluna and Harrison were not engaged in activity which brought them within the scope of Rule 10b-6. Therefore, this finding by the Commission is clearly erroneous.

IV.

SUBSTANTIAL EVIDENCE DOES NOT SUPPORT A FINDING OF VIOLATIONS BY PETITIONERS OF THE ANTI-FRAUD PROVISIONS OF THE ACT

A. Since even the preponderance of the evidence does not establish manipulative activity, the respondent's findings and opinion are arbitrary and capricious; the "whole record" does not support respondent's conclusion.

The respondent feels that Pennaluna's bidding and trading activity was indicative of a "typical manipulative campaign," that Pennaluna purchased and sold at prices lower than its bids, and that Pennaluna's bids were artificial and designed to mislead. (Resp. Br. 55).

The following chart sets forth bid and ask quotations and the high purchase and sale figure for Pennaluna

on Mondays (as a representive day), during October, November, and December, 1962. The number of shares shown are the total number of shares purchased in one or more transactions at that price and do not necessarily represent an individual transaction or the total number of shares purchased and sold on that date. This information is contained in charts at pages 2442-2443 and 2399-2417 of the Record.

	Bid and Ask	Total shares Purchased	Price	Total shares Sold	Price
10-1	22 — 25	2,000	23c	2,000	25c
10-8	26 — 30	5,500	27c	14,500	2 8c
10-15	27 — 30	500	29c	500	30c
10-22	25 — 30	2,000	25c	300	27c
10-29	30 — 34	10,500	31c	2,000	33c
11-5	42 — 50	300	44c	7,000	45c
11-12	44 — 48	2,000	45c	11,000	46c
11-19	50 —	750	50c	1,000	52½c
11-26	60 — 67	3,000	63c	1,700	70c
12-3	75 — 80	4,000	75c	3,000	79c
12-10	60 — 70	2,800	60c	1,000	65c
12-17	80 — 90	1,700	80c	300	85c
12-26 (Wed.)	83 — 90	7,000	83c	1,000	87½c
12-31	95 —	100	1.00	3,000	1.02

A bid is not artificial when a dealer is willing to purchase a substantial number of shares for a substantial amount of money at prices equal to or *greater than* his bid. The Record confirms that Pennaluna's bids were firm, not artificial.

Pennaluna bought at least 432,600 shares during this period in many transactions at various prices in addition to the 100,000 shares purchased from New Park-East Utah on September 29, 1962. (R. 2938; App. 1). The 100,000 shares were sold as a part of its normal trading activity along with other shares purchased, not as the focal point of improper activity. Pennaluna's trading pattern, on its face, completely contradicts the respondent's finding of manipulation.⁵

By stipulation, Pennaluna and Harrison did not have any inside information, even if it was available, (R. 151; R. 215; Br. App. 9-14)⁶, and both petitioners Pennaluna and Harrison were entitled to participate in a normal market as a normal broker dealer. The TWX conversations are set forth in the Appendix to peti-

^{5.} The Commission found only that Pennaluna's activities contributed substantially to the increase in trading and rise in price. (R. 4614; Br. App. 114). It did not find that Pennaluna conducted a "typical manipulative campaign."

^{6.} Despite the stipulation, the respondent still implies that Harrison possessed inside information. (Resp. Br. 51). This is the full message, only the unemphasized part of which was included by the respondent in the footnote:

[&]quot;May & Co. then asked, 'What is the inside on Silver Buckle, go ahead.' Harrison replied, 'I just got a new Brokerage Information Sheet out on it — giving full details. Will mail you some. Silver Buckle is 25-30 here — close in market is 26-27.'" (R. 229)

[&]quot;Inside" logically referred to the quotes as it did in the TWX conversation set forth at page 102 of the Appendix. Respondent should check its own definition of "inside-outside" in Barrett & Co., 9 S.E.C. 319, 323 (1941).

This is the same type of prejudicial argument used by Lane Emory, the Division representative, before the Commission and which respondent now admits was improper. (Br. 71; Resp. Br. 62).

tioners brief for this Court's examination. The respondent still completely fails to understand the concept of inter-dealer communication; since the respondent is seeking to establish new obligations in the wholesale market, it should forthrightly admit its purpose rather than trying to refashion the facts of this case into a "typical manipulative campaign."

Finally, Pennaluna was long 47,873 shares of Silver Buckle on July 2, 1963, (R. 2437) which were then converted into shares of West Coast. This long position contradicts respondent's contention that a sell-off began on May 2, 1963. (Resp. Br. 28). This long position is not consistent either with knowledge of financial status of West Coast, or with an ability to control a market.

٧.

CONCLUSION

Petitioners are entitled to fair play before government agencies. In addition to facts mentioned in the opening brief, it should be emphasized that petitioners waived their right to an initial hearing before a Hearing Examiner on July 30, 1965, a month and a half before the Division's opening brief, filed after the waiver and after the stipulation, presented the Division's demand for revocation and bar for the first time. Because of the nature of this proceeding, the petitioners have been denied the minimum protection of the judicial and administrative fact finding process.

This Court cannot resolve the issues herein without specific findings and a clear presentation of the basis for respondent's decision. *Berko v. Securities and Exchange Commission*, 297 F. 2d 116 (1961).

It is respectfully submitted that this Court must reverse and set aside the order of the respondent and remand this case to the respondent for a further determination consistent with the Record and respondent's administrative obligations.

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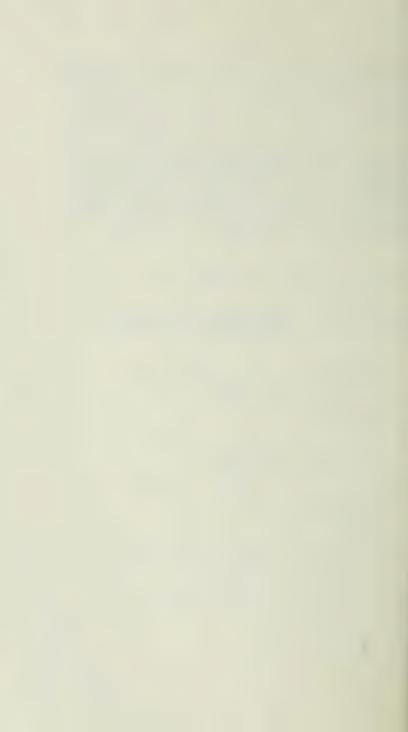
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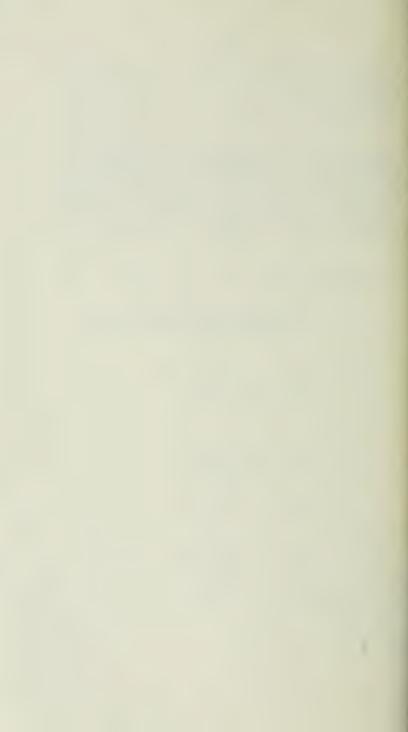
I certify that, in connection with the preparation of this Brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Laurens Phralf



App. 2

Broker	Location L	Position At Beginning : Long / S: S
John J. O'Kane	N.Y.C.	-0-
Gearhart & Otis	N.Y.C.	-0-
Harris Upham		-0-
Cromer Brokerage	Salt Lake City, Utah	-0-
Wallace Brokerage	Wallace, Idaho	21500L
D. A. Davidson & Co	Great Falls, Montana	-0-
Ingalls & Snyder	N.Y.C.	-0-
Dean Witter		-0-
Merrill Lynch P. F. & S		-0-
Geo. D. Bonbright & Co	Rochester, N.Y.	-0-
F. D. Ford	Spokane, Wash.	-0-
Brukenfeld & Co	N.Y.C.	-0-
C. H. Hunter Sec	Coeur d'Alene, Ida.	3000L
Guss & Stead Co	Salt Lake City, Utah	-0-
Pacific Northwest Co	Seattle, Wash.	-0-



This chart (R. 2938-2940) sets forth the total volume of purchases and sales for 92 brokers actively trading solver Buckle shares from September 1, 1962 through December 4, 1962.

SILVER BUCKLE MINING CO. TRANSACTIONS IN PERIOD 9-1-62 to 12-4-62 VOLUME FOR ENTIRE PERIOD: 2,512,462 SHARES

		Position At		8 O U G H T			SOLD	
Broker	Location	Beginning L Long S Short	As Agent	As Principal	Total Bought	As Agent	As Principal	Total Sold
Pennaluna & Co	Wallace, Idaho	27005L		532,600	532,600		562,205	562,205
G. Everett Parks & Co	N.Y.C.	-0-		97,200	97,200		98,950	98,950
J. May & Co	N.Y.C.	-0-	5,000	141,450	146,450	2,500	135,950	138,450
Standard Securities	Spokane, Wash	3981L	15,700	22,913	38,613	58,100	18,550	76,650
L. E. Nicholls & Co	Spokane, Wash.	4000L	5,000	41,000	46,000	18,000	44,000	62,000
R E Nelson & Co	Spokane, Wash.	4000L	1,000	109,600	110,600	2,000	114,700	116,700
Cleek-Endell	Spokane, Wash.	2619L		74,155	74,155		78,074	78,074
J. A. Hogle & Co		100 UL	66,720	38,000	104,720	141,450	41,100	182,550
J. L. Schaffman	Jersey City, N.J.	5300L		10,300	10,300		19,600	19,600

	G	

9,700

1,000

10,700

12,500

1,000

13,500

As Agent	As Principal	Total Bought	As Agent	As Principal	Total Sold
	16,700	16,700		54,500	54,500
100	6,000	6,100	100	6,000	6,100
68,300		68,300	16,000		16,000
7,200	48,000	55,200	73,400	46,800	120,200
	69,500	69,500		130,850	130,850
5,000	30,150	35,150		28,750	28,750
		0	107,000		107,000
37,950		37,950	7,600		7,600
58,200		58,200	9,900		9,900
26,800		26,800	700		700
18,466	1,000	19,466			C
		0	43,300		43,300
	14,839	14,839	8,000	13,000	21,000
	2,000	2,000	2,000	13,000	15,000

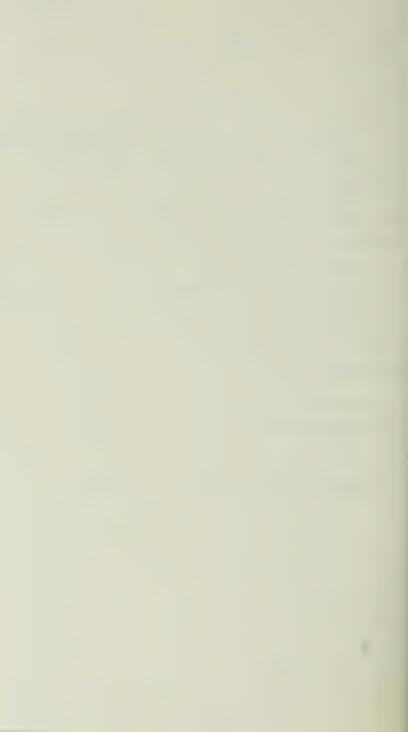
SOLD

		Position At		B O U G H T			S O 1 D		
Broker	Location L:	Beginning Long / S: Short	Agent	As Principal	Total Bought	As Agent	As Principal	Total Sold	
John J O'Kane	N.Y.C.	-0-		16,700	16,700		54,500	54,700	
Gearhart & Ous	N.Y.C.	-0-	100	6,000	6,100	100	6,000	6,101	
Harris Upham		-0-	68,300		68,300	16,000		16 000	
Cromer Brokerage	Salt Lake City, Utah	-0-	7,200	48,000	55,200	73,400	46,800	120 200	
Wallace Brokerage	Wallace, Idaho	21500L		69,500	69,500		130,850	130,810	
D. A. Davidson & Co	Great Falls, Montana	-0-	5,000	30,150	35,150		28,750	2 (,)	
Ingalls & Snyder	N.Y.C.	-0-			0	107,000		107,660	
Dean Witter		-0-	37,950		37,950	7,600		7,600	
Merrill Lynch P. F. & S		-0-	58,200		58,200	9,900		G _i Stat	
Geo. D. Bonbright & Co	Rochester, N.Y.	-0-	26,800		26,800	700		700	
F. D. Ford	Spokane, Wash.	-0-	18,466	1,000	19,466			a	
Brukenfeld & Co	N.Y.C.	-0-			0	43,300		43,300	
C. H. Hunter Sec	Cocur d'Alene, Ida.	3000L		14,839	14,839	8,000	13,000	21,000	
Guss & Stead Co	Salt Lake City, Utah	-0-		2,000	2,000	2,000	13,000	15,000	
Pacific Northwest Co	Seattle, Wash.	-0-	9,700	1,000	10,700	12,500	1,000	13,500	

_	_				_
- 12	_	- 11	G	- 14	T

	BOUGHT			SOLD	
As Agent	As Principal	Total Bought	As Agent	As Principal	Total Sold
	16,700	16,700		54,500	54,500
100	6,000	6,100	100	6,000	6,100
68,300		68,300	16,000		16,000
7,200	48,000	55,200	73,400	46,800	120,200
	69,500	69,500		130,850	130,850
5,000	30,150	35,150		28,750	28,750
		0	107,000		107,000
37,950		37,950	7,600		7,600
58,200		58,200	9,900		9,900
26,800		26,800	700		700
18,466	1,000	19,466			0
		0	43,300		43,300
	14,839	14,839	8,000	13,000	21,000
	2,000	2,000	2,000	13,000	15,000
9,700	1,000	10,700	12,500	1,000	13,500

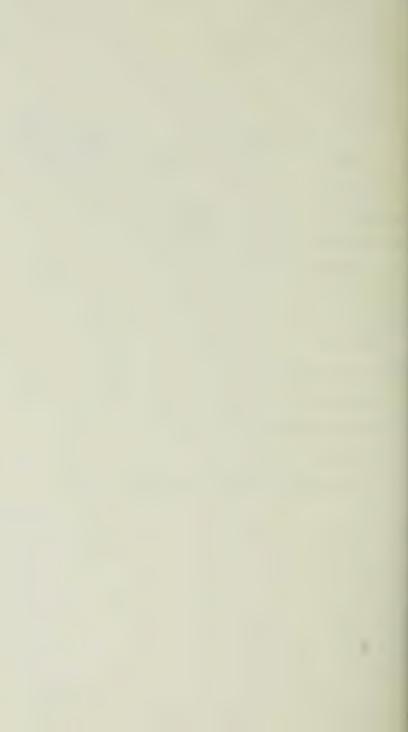
		Position At	BOUGHT			SOLD		
Broker	Location	Beginning L: Long / S Short	As Agent	As Principal	Total Bought	As Agent	As Principal	Total Sold
Walston & Co		-0+	19,000		19,000	4,500		4,500
Richards, Merrill & Peterson	Spokane, Wash.	-0-		4,100	4,100		4,100	4,100
Greenshields & Co	N.Y.C.	-0-			0	14,000		14,000
J. K. Rice Jr. & Co	N.Y.C.	-0-	3,000	7,400	10,400		7,800	7,800
May & Co Inc	Portland, Ore.	-0-	9,000	1,000	10,000			0
Bache & Co		-0-	10,400		10,400	2,000		2,000
H. Hentz & Co		-0-	7,500		7,500			0
Eastman Dillon, Union Sec		-0-	9,000		9,000			0
Total 32 brokers					1,651,943			2,041,979
60 other brokers (less active)					861,519			‡ 70, ‡ °3
92 brokers								
Total to agree with schedule F	orm 10 — Daily Tr	ansactions			2,512,462			2,512,462



This chart sets forth the daily purchases and sales by brokers during the month of September 1962.

(R. 2941-2945).

		September 4	, 1962		
PURCH	ASES				SALES
For Whom Bought	Broker	Shares	Price	Broker	For Whom Sold
Firm A/C	C. E. Ruple	200	19c	R E Nelson & Co.	Firm A, C
Imm A/C	Cromer Brokerage	7,000	18c	J. A. Hogle	
		September 5	, 1962		
Inn A, C	J. A. Hogle	7,000	18c	Cromer Brokerage	Firm A/C
		September 6	, 1962		
Wayne Fellers	[D Ford	2,000	16c	Pennaluna	1 um A/C
Geo. Cappas & Dea Karas Cleveland, Ohio		200	23.	C. E. Ruple	Firm A/C
J.A. McCartney Wenatchee, Wash.		<u>500</u> 2,700	19c	Cleek-Tindell	Firm A/C
		September 2	7, 1962		
Ulfred I Ingina Otis Orchards, Wash.	Harris Upham	1,000	17c	Pennaluna	Firm A. C.



		September 1	1, 1962		
PUR	CHASES				SALES
For Whom Bought	Broker	Shares	Price	Broker	For Whom Sold
Limit A, C	Cromer Brokerage	1,000	18c	J. A. Hogle	Firm A, C
Lirm A. C.	Cleek-Tindell	2,000	17c	Pennaluna	Firm A/C
Ernest Pappas Spokane, Wash		2,000 5,000	18c	Cleek-Tindell	Firm A/C
Daniel 1. Weston		September 1	12, 1962		
Concord, Calif.	Standard Securities Corp.	2,000	17!4c	Pennaluna	Firm A/C
Ima A C	L E. Nicholls	1,000	17½c	Pennaluna	Firm A/C
Heber H. Routh Spokane, Wash.		2,000	18½c	L. E. Nicholls	Firm A/C
Hober H. Routh Spokane, Wash.		1,000	18½€	L. E. Nicholls	Firm A/C
G. H. Sonnicksen Cocar d Mene, Ida		1,000	18½c	C. H. Hunter	Firm A/C
		7,000			
		September 1	13, 1962		
Firm A/C	I E. Nicholls	1,000	1734c	Pennaluna	Firm A/C
Firm A/C	R. E. Nelson	2,400	17c	Cromer Brokerage	L L Gron
		3.400			

er 11, 1962

SALES		
Broker	For Whom Sold	
J. A. Hogle	Firm A/C	
Pennaluna	Firm A/C	
Cleek-Tindell	Firm A/C	
	J. A. Hogle Pennaluna	

er 12, 1962

17¼c	Pennaluna	Firm A/C
17⅓2c	Pennaluna	Firm A/C
18½c	L. E. Nicholls	Firm A/C
18½c	L. E. Nicholls	Firm A/C
18½c	C. H. Hunter	Firm A/C

er 13, 1962

173/4c	Pennaluna	Firm A/C
17c	Cromer Brokerage	L. L. Cromer

		Septe
	HASES	61
For Whom Bought	Broker	51
Firm A/C	Cleek-Tindell	1,0
Rolf K. Rieger Seattle, Wash.		1,0
Firm A/C	L. E. Nicholls	2,0
Firm A/C	Cleek-Tindell	2,0
Alfred Liebel Minot, N.D.		2
Carl Dralle, Spokane, Wash.		2,0
J. Russell Tindell, Partner		2,0
Chas. S. Adams Spokane, Wash.		5
		10,7
		Sept
Jack M. Neilson, Spokane, Wash.	J. A. Hogle	1,0
James R. Newhouse Spokane, Wash.	J. A. Hogle	1,0
Joseph Marnien Philadelphia, Pa.		
Richard M. Plumb		
Missoula, Mont.		2,
		Sep
Firm A/C	Pennaluna	100,

App. 7

PURCHASES		September 1	8, 1962		SALES
For Whom Bought	Broker	Shares	Price	Broker	For Whom Sold
Firm A/C	Pennaluna	1,000	16⅓2c	M. L. P. F. & S.	Louis Silbe Haddonfield, N.J.
		September 1	9, 1962		
B. Arthur Aspy Clarksburg, W. Va.	Standard Securities Corp.	1,000	17c	Pennaluna	Firm A/C
Mrs. Marjory B. Butcher Spokane, Wash.	Standard Securities Corp.	1,000 2,000	17c	Pennaluna	Firm A/C
		September 2	24, 1962		
James & Betty Sorg Sierra Madre, Calif.	Eastman Dillon	1,000	18½c	J. A. Hogle	Firm A/C
Firm A/C	Cleek-Tindell	2,000	17c	Pennaluna	Firm A/C
		September 2	25, 1962		
Firm A/C	Cleek-Tindell	1.000	17c	Pennaluna	Inm A C
September 26, 1962					
Ted Bronstein Seattle, Wash.		1,000	18c	Pennaluna	Firm A/C

puec	HASES	September 2	7, 1962		
For Whom Bought	Broker	Shares	Price	Broker	SALES For Whom Sold
Firm A/C Rolf K. Rieger	Cleek-Tindell	1,000	17c	J. A. Hogle	Mr. Sylvan Mallenson Los Angeles, Calif.
Seattle, Wash.		1,000	18½c	Pennaluna	Firm A/C
Firm A/C	L. E. Nicholls	2,000	18½c	J. A. Hogle	Firm A/C
Firm A/C Alfred Liebel	Cleek-Tindell	2,000	17½c	Cromer Brokerage	Fern Templon, Muncie, Ind.
Minot, N.D. Carl Dralle.		200	20c	Johnson Lowry & Co.	Firm A/C
Spokane, Wash.		2,000	18c	Cleek-Tindell	Firm A/C
J. Russell Tindell, Partner		2,000	173/4c	Cleek-Tindell	Firm A/C
Chas. S. Adams Spokane, Wash.		500 10,700	20 c	Cleek-Tindell	Firm A/C
		September 2	8, 1962		
Jack M. Neilson, Spokane, Wash.	J. A. Hogle	1,000	18c	R. E. Nelson & Co.	Firm A/C
James R. Newhouse Spokane, Wash.	J. A. Hogle	1,000	18c	R. E. Nelson & Co.	Firm A/C
Joseph Marnien Philadelphia, Pa.		100	20c	Cleek-Tindell	Firm A/C
Richard M. Plumb Missoula, Mont.		685 	19c	Cleek-Tindell	Firm A/C
		September 2	9, 1962		
Firm A/C	Pennaluna	100,000	20c		New Park Mining Co.

r 27, 1962

r 27, 1962		SALES
Price	Broker	For Whom Sold
17c	J. A. Hogle	Mr. Sylvan Mallenson Los Angeles, Calif.
18½c	Pennaluna	Firm A/C
18½c	J. A. Hogle	Firm A/C
17½c	Cromer Brokerage	Fern Templon, Muncie, Ind.
20c	Johnson Lowry & Co.	Firm A/C
18c	Cleek-Tindell	Firm A/C
173/ ₄ c	Cleek-Tindell	Firm A/C
20c	Cleek-Tindell	Firm A/C
r 28, 1962		
18c	R. E. Nelson & Co.	Firm A/C
18c	R. E. Nelson & Co.	Firm A/C
20c	Cleek-Tindell	Firm A/C
19c	Cleek-Tindell	Firm A/C
r 29, 1962		

r 29, 1962

20c New Park Mining Co.

WALL STORY CLINES

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PENNALUNA & COMPANY, INC.
BENJAMIN A. HARRISON, and
HARRY F. MAGNUSON,

. Petitioners.

V.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR REVIEW OF ORDER OF SECURITIES EXCHANGE COMMISSION

REPLY BRIEF OF PETITIONER MAGNUSON

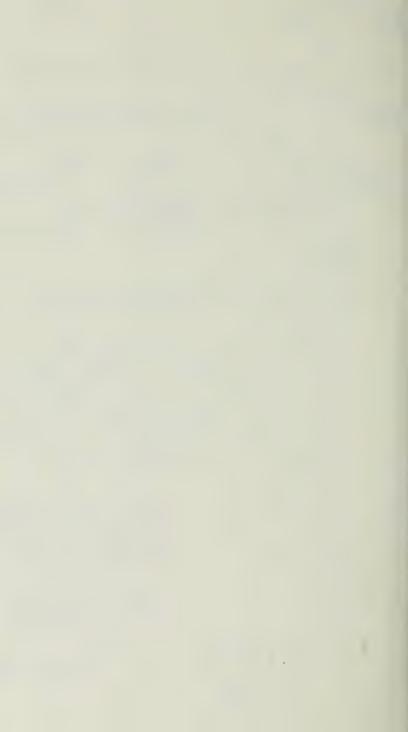
Saxon, Maguire & Tucker 2000 L Street, N. W. Washington, D. C. 20036 By William J. Kenney

LeSourd and Patten 1140 Washington Building Seattle, Washington 98101 By Walvin L. Patten

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Attorneys for Petitioner Harry F. Magnuson



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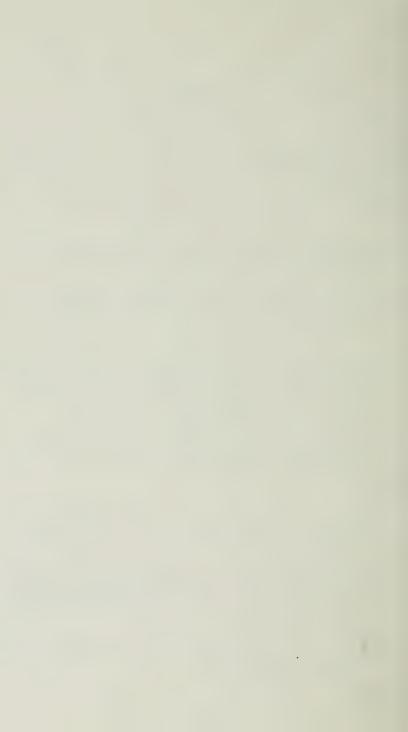
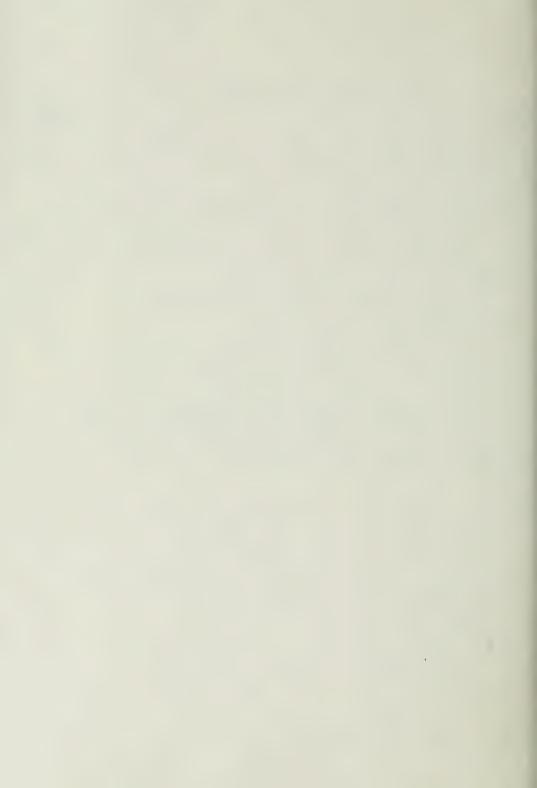
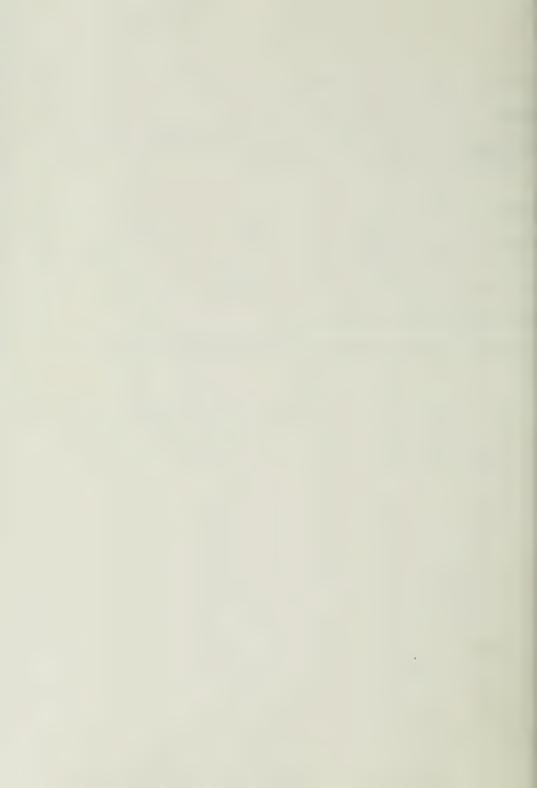


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UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PENNALUNA & COMPANY, INC.
BENJAMIN A. HARRISON, and
HARRY F. MAGNUSON,

Petitioners,

V. :

SECURITIES AND EXCHANGE COMMISSION, :

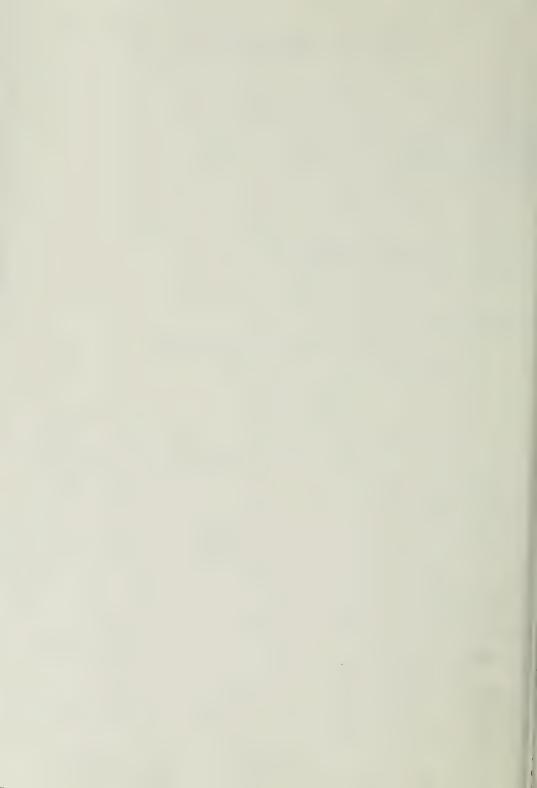
Respondent.

No. 22143

REPLY BRIEF FOR PETITIONER MAGNUSON

INTRODUCTION

The General Counsel's brief for Respondent contends
that substantial evidence supports the Respondent's finding that
Petitioner Magnuson was a controlling person of Silver Buckle
Mining Company and West Coast Engineering, Inc. throughout the
Deriod of alleged distribution; that substantial evidence supports
the Respondent's finding of allegedly willful violations of the
Cantifraud and antimanipulation provisions of the Securities laws;
that the sanctions imposed were well within the discretionary
Cauthority of the Respondent Commission; and, that Petitioners'
Cobjections to the staff's conduct are untimely and without merit.



Part I of this Reply shall address itself to each such contention.

In addition, Part II shall reply to the conclusion of the

Respondent's General Counsel that the evidentiary and procedural

standards were adequate in law.

PART I.

The Statement of Facts in the instant proceeding reads

(a) Substantial Evidence Does Not Support
The Commission's Finding on Questions
of Control

the Cour D'Alene Mining District. A single incident of

Petitioner Magnuson's accounting firm rendering service to Silver

Buckle -- of 18 years past -- becomes the opening warp of the

blanket of intrigue. Slight business and social relationships

in this district of low population density becomes the framework

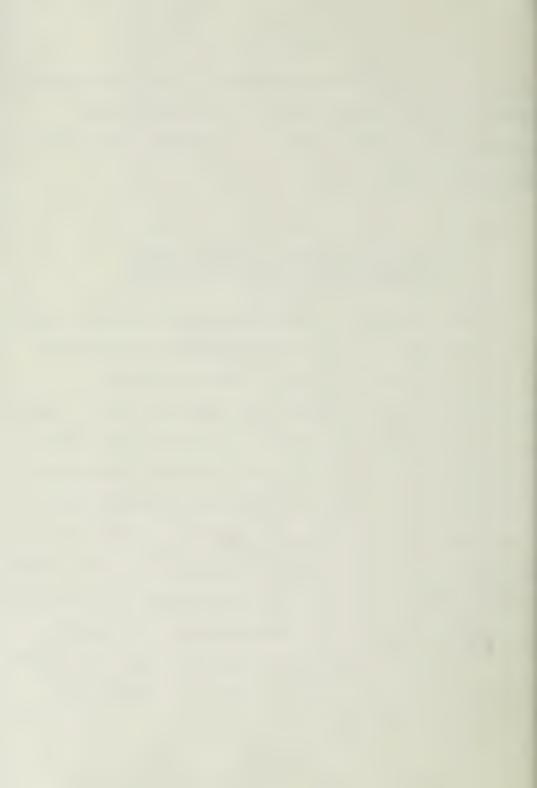
of the story. Petitioner Magnuson's efforts to salvage the

financial investment of the stockholders once he, in fact, became

involved, becomes the proof. But, the Respondent has wholly ignor

the problems of relevancy and reasonableness in its findings.

We shall not burden this Court with further restatement of the facts. We simply refer to the Brief of Petitioners.



Dr. Scott's unrefuted testimony establishes that the group in control of Silver Buckle from the time of Petitioner Magnuson's purchase until the June, 1963 merger included Gay, the Browns, the West Coast directors and himself [Tr. 2050-2051]. At any extent, even conceding, arguendo, that in fact a control relationship existed, substantial evidence does not support the contention that any ensuing breaches of the Act were willful.

(b) Substantial Evidence Does Not Support The Commission's Finding of Allegedly Willful Violations of the Act

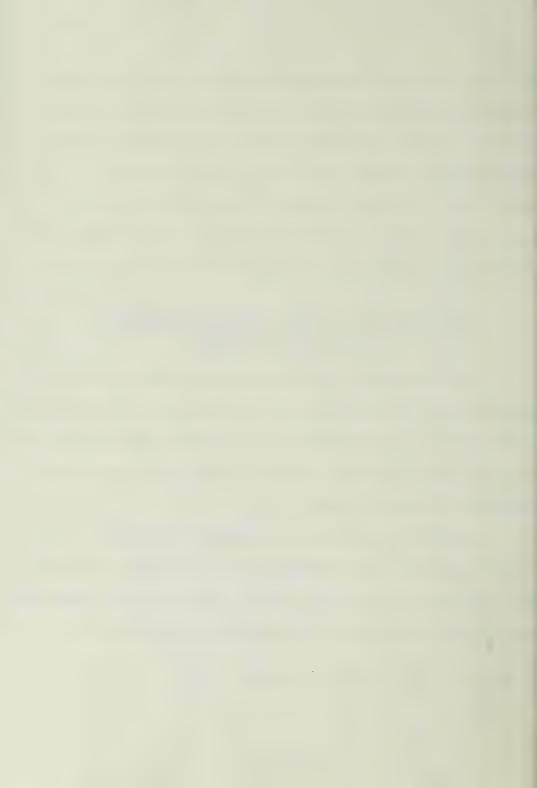
The Respondent Commission contends that Petitioner

Magnuson was a controlling person, that his sales of stock were

intentional and with knowledge of his control relationship, and,
that they were, therefore, willful. These findings ignore the
substantial facts of record.

The facts are that when Petitioner Magnuson purchased his Silver Buckle stock from New Park and East Utah, New Park was in possession of a legal opinion, the validity of which does not appear to be contested, holding that New Park was not a

^{1/} We, of course, do not so concede.



"control person" vis-a-vis Silver Buckle [Tr. 196, 2183]. This opinion was conveyed to Petitioner Magnuson at the time of his purchase of the Silver Buckle stock. Similarly, it was warranted to Petitioner Magnuson at the time of purchase, that the New Park and East Utah Silver Buckle stock were not subject to any S. E. C. restrictions [Tr. 1214, 2592]. Clegg, counsel for New Park and East Utah, and one who knew fully of Petitioner Magnuson's other interests and involvements [Tr. 197, 1185, 1197, 1215], told Petitioner Magnuson that the stock could be traded [Tr. 1215].

Finally, subsequent to the purchase of the Silver Buckle stock, Petitioner Magnuson received a legal opinion from still another source, Piatt Hull. Hull is a Wallace, Idaho attorney whose firm served as Petitioner Magnuson's personal counsel [Tr. 983], and had drafted the New Park-East Utah agreements [Tr. 1215 Petitioner's unrefuted testimony is that he told Hull everything that was involved [Tr. 983]. That opinion advised Petitioner Magnuson that he was not a person in direct or indirect control of Silver Buckle. Petitioner Magnuson himself has testified that he did not feel he could influence the management of Silver Buckle, and that he was not the controlling person at this time [Tr. 1218].



In Williamson v. U. S., the Supreme Court held that the following jury charge adequately stated the principal governing celiance on advice of counsel:

"If a man honestly and in good faith seeks advice of a lawyer as to what he may lawfully do in the matter ... and fully and honestly lays all facts before his counsel and in good faith and honestly follows such advice, relying upon it and believing it to be correct, and only intends that his acts shall be lawful, he could not be convicted of a crime which involves willful and unlawful intent."

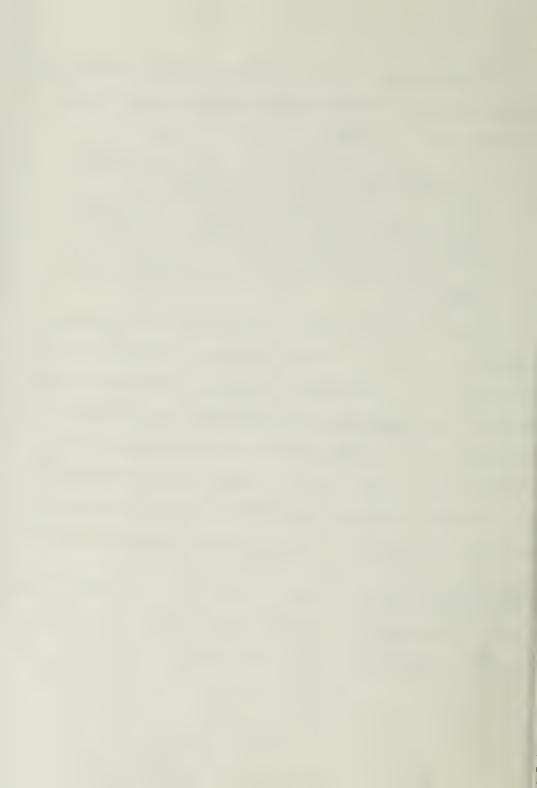
Similarly, under the Internal Revenue Code, the courts recognize that the word "willful" as respects offenses of willfully and knowingly attempting to defeat and evade income taxes means more than intentionally or voluntarily, and includes an evil motive, or bad purpose, so that an actual bonafide misconception of the law would justify a verdict for the defendant.

It is, of course, true that legal advice does not constitute an $\frac{4}{2}$ unpregnable wall of defense, and that legal advice is a fact to

^{2/} Williamson v. U. S., 207 U.S. 425, 52 L. Ed. 278, 292-93 (1908)

^{3/} U. S. v. Phillips, 217 F.2d 435, 438-41 (1955).

^{4/} Linden v. U. S., 254 F.2d 560, 568 (1958).



be considered with other facts in determining the question of 5/
the defendant's good faith. However, there is no justification in the facts of this record for the Respondent Commission's contention that the counsel failed to give consideration to certain 6/
facts [Tr. 4613]. In any event, the Respondent Commission failed to apply the proper standard in evaluating the effect, if any, of the reliance on advice of counsel in the present proceeding.

We submit that where, as here, Petitioner Magnuson's good faith reliance on advice of his counsel is uncontested, he cannot be found to have willfully violated the Securities Act by the sale of unregistered stock. The relief sought is the quasipunative action of revocation and debarment. We do not suggest that reliance on advice of counsel would defeat an action where the relief sought is truly remedial, i.e., the injunctive prohibition in the future of acts deemed in violation, or the recovery of damages incurred in the purchase of such stock; those problems simply are not involved.

^{5/} U. S. v. Shaefer, 299 F.2d 625, 630-31 (1962).

^{6/} Securities and Exchange Commission Release No. 8063, p. 3.



(c) The Sanctions Imposed Are So Disproportionate
To The Violations Alleged and Found as to
Constitute An Abuse of Discretion on The
Part of The Respondent Commission

We urgently plead the Court to focus upon the severity

of the sanctions here imposed. Wholly aside from any prior representation by the Respondent's staff as to what sanctions \frac{7}{}/\text{were deemed appropriate,} the sanctions here adopted are neither reasonable nor just in the factual circumstances involved. We do not question that the Respondent is empowered by the Congress to impose such a penalty. We submit, however, that its imposition

in the factual circumstances here is a clear abuse of discretion.

For example, permanent debarment for an attorney in comparable circumstances -- first offense, previously unblemished record, a pillar of the community with a history of active support of regulatory activity -- would be untenable. The permanent barring of an individual from the pursuit of his profession, on his first offense, is, indeed, an abuse of discretion constituting cruel and unusual punishment proscribed by 9/
the Eighth Amendment.

^{7/} This matter will be discussed in Section (d) hereof.

^{8/} Sacher v. Association of the Bar of the City of New York, 347 U.S. 388, 74 S. Ct. 569, 98 L. Ed. 790; see also, Re Isserman, 345 U.S. 286, 73 S. Ct. 676, 97 L. Ed. 1013; debarment set aside on reh., 348 U.S. 1, 75 S. Ct. 6, 99 L. Ed. 3.

^{9/} Weems v. U. S., 217 U.S. 349.



As noted by the Court in Gonzales v. Freeman:

"The consequences of administrative ... debarment, will vary, depending upon multiple factors: the size and prominence of a contractor; the ratio of ... [debarred] ... business to ... [non-debarred] business;.... The impact of debarment ... may be a sudden contraction of bank credit, adverse impact on market price of shares, ... and critical uneasiness of creditors generally, to say nothing of 'loss of face' in the business community. These consequences are in addition to the loss of specific profits from the business denied as a result of debarment. We need not resort to a colorful term such as 'stigma' to characterize the consequences of such governmental actions, for labels may blur the issues. But we strain no concept of judicial notice to acknowledge these basic facts of economic life. "10/

Debarment has been characterized as "so severe that its imposition may destroy a going business, ... the power of debarment is tantamount to one of life or death over a business."

Conceding, arguendo, that such power is vested in the Respondent Commission, we turn to the question: Is it appropriat in the present case? In the Federal system, the Court of

^{10/} Gonzales v. Freeman, 334 F.2d 570, 574.

^{11/} Comp. Gen., Dec. B-139720 (Jan. 6, 1960). Unpublished letter to Secretary of Labor, quoting the Attorney General's Committee on Administrative Procedure, Division on Public Contracts.



Military Appeals has established an unmatched expertise in the field of evaluating the appropriateness of a particular sanction to a particular factual pattern. In setting up the Uniform Code of Military Justice, the Congress and the President called on the best minds in the fields of criminology, penalogy, sociology, and the law. Their combined efforts find expression in Paragraph 76a of the Manual for Courts of Martial. With respect to what constitutes the appropriate sanction, it is stated:

"Normally, the maximum punishment will be reserved for an offense which is aggravated by its circumstances and the conditions surrounding its occurrence — or a case in which there is evidence of a previous conviction involving an offense at least as serious as the one for which the accused is on trial."

The Court of Military Appeals, in implementing this Act, has held that "a sentence which is not fair and just should not be approved."

The military courts are not alone in recognizing that the imposition of sanctions can be the subject of abuse. It has

^{12/} Manual for Courts Martial, § 76a (1951). The Manual is, of course, the regulations promulgated by the President for implementation of the Uniform Code of Military Justice, 10 U.S.C. 801-939.

^{13/} U. S. v. Cavallero, 36 U.S.C.M.A. 653, 654.



been held that long-term imprisonment could be so disproportionate to the offense as to fall within the inhibition (Eighth Amendment prohibition against cruel and unusual punishment). And, where the record showed that the defendant was a first offender and did not indicate the case was an aggravated one, it was held that the imposition of the maximum sentence was "greater than should 15/ have been imposed."

We are, of course, left to conjecture as to what prompted the imposition of the maximum sanction in the present proceeding. Whereas, staff initially suggested settlement for a brief suspension, as the parties, and their counsel sought to assert their rights to defend themselves, the price of settlement increased. Having rejected settlement and sought a ruling of the Respondent Commission, they are now faced with permanent debarment from the pursuit of their professions. This strongly suggests that the Respondent seeks here to convey a message to those subject to its powers that it looks with disfavor on those who seek to defend themselves against the Respondent staff's

^{14/} Hemans v. U. S., 163 F.2d 228, 237, 238.

^{15/} Smith v. U. S., 273 F.2d 462.



accusations -- those who defend rather than submit -- will be punished.

This practice has been rightly severely critical by the courts. In <u>U. S. v. Wiley</u>, after noting that (as here) the defense was neither frivolous or in bad faith, the Third Circuit stated:

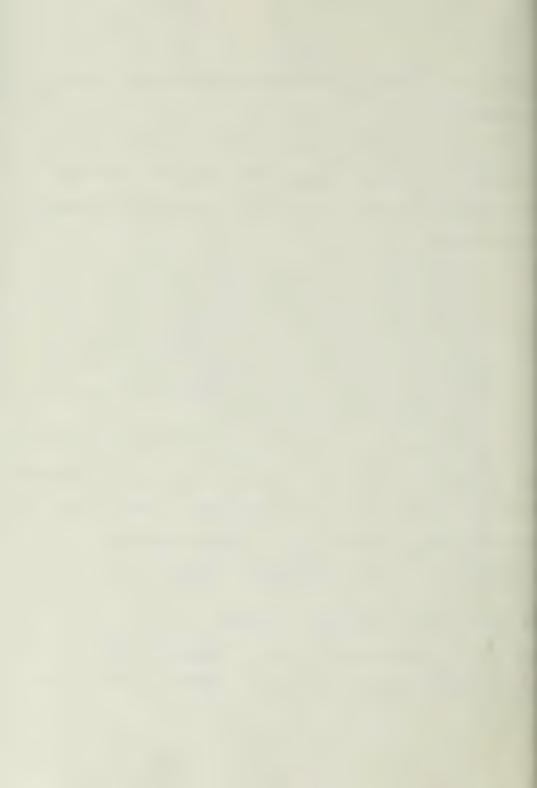
"Our part in the administration of federal justice requires that we reject the theory that a person may be punished because in good faith he defends himself when charged with a crime, even though his effort proves unsuccessful. It is evident that the punishment imposed by the district court on Wiley was in part for the fact that he had availed himself of his right to a trial, and only in part for the crime for which he was indicted." 16

We earnestly submit that judicial precedent establishes that the maximum sanction is appropriate only for the aggravated $\frac{17}{\text{case.}}$ We recognize that the imposition of sanctions such as debarment are an important tool in the administration of the Securities Act. But, in imposing a sanction in each particular

^{16/} U. S. v. Wiley, 278 F.2d 500, 504.

^{17/} U. S. v. Smith, supra.; U. S. v. Cavallero, supra.

^{18/} Cf. Copper Heating & Plumbing v. Campbell, 290 F.2d 368.



to its quasi-judicial capacity. The courts have held that in imposing sanctions, administrative policy, per se, has no 19/valid place, and that sanctions should not be imposed by a 20/fixed formula, but, rather, the quantum should be fixed as it is specially suited to the circumstances of the parties in

Assuming, arguendo, the Respondent properly found willful violations of the Securities Act, we earnestly submit that the sanctions inflicted demand revision; and that in no event is a suspension in excess of 60 days appropriate on the factual circumstances. We recognize that it is not customarily the province of this Court to re-assess sanctions imposed or sentences assessed. We, therefore, earnestly suggest that if the Court finds adequate support for the findings of violations herein, the matter be remanded to the Respondent Commission for re-evaluation of the penalties assessed in conformance with such guidance as the Court deems appropriate.

each case.

^{19/} U. S. v. Cavallero, supra.

^{20/} U. S. v. King, 12 U.S.C.M.A. 71, 74.

^{21/} U. S. v. Judd, 11 U.S.C.M.A. 164, 170, Judge Fergusan's concurring opinion.



(d) Petitioners' Objections to Staff Conduct Both Timely and Meritorious

By action of the Secretary dated September 12, 1967, the Respondent Commission rejected for filing a Petition and Motion for Further Rehearing, Reconsideration and Review in this proceeding, bearing date of September 1, 1967, which was served on the Respondent Commission on September 5, 1967. That Petition and Motion, which are appended herein as Exhibit A, brought to the Respondent Commission's attention, apparently for the first time, certain allegations concerning the conduct of the staff of the Respondent in the present proceeding, and also contended that the penalties assessed herein constituted an abuse of discretion in general conformance with the arguments raised in Section (c) hereof.

The Petition and Motion in substance contended that the staff of Respondent materially misled the parties and their counsel as to the gravity with which the matter under investigation was viewed by their superiors and by the Respondent Commission.

It pointed out that the parties were grossly misled as to the punative measures deemed appropriate to the offenses which the staff considered to have been established. This attitude by the staff of the Respondent trapped and misled the parties and their



Fact, which they believed that would be all that would be placed before the Respondent Commission in the course of the procedures adopted. The Petition further contended that the staff of the Respondent, by assumption of an extreme adversary role, had reduced the proceeding to one similar to that castigated by the $\frac{22}{\sqrt{2}}$

We earnestly suggest that the allegations raised by the Petition and Motion are of such gravity and of such a nature as to demand, in the interest of justice, consideration by the Respondent Commission. As is evident by the recent Petition for Amendment of Record herein, filed by your Petitioners, material evidence, in fact, exists to support Petitioners' contention in the above Petition and Motion that they had been affirmatively misled as to the real intentions and demeanor of the staff.

It is earnestly suggested that where contentions of this nature are raised, the interest of justice and administrative process demand their evaluation by the Commission. Accordingly,

^{22/} Giles v. Maryland, 385 U.S. ___, 17 L. Ed.2d 737.



the record herein should be remanded to the Commission for further hearings on this issue. In the alternative, we urge this Court to consider the propriety of the staff's conduct of this case. In an administrative proceeding, such as the instant case, it "is not a game in which the [staff's] function is to outwit and entrap its quarry. The [staff's] pursuit is justice, not a victim." Thus, staff and the Commission must insure fair consideration to all evidence in the case, and when their participation establishes a propensity to convict, regareless of matters presented, justice demands reversal of such actions. We submit that failure to comport to these standards in the instant proceedings has resulted in a proceeding which is making mockery of the Petitioners' rights to administrative due process.

PART II.

This shall be discussed in Part II below.

THE PROCEEDINGS HEREIN DO NOT COMPORT WITH ADMINISTRATIVE DUE PROCESS OF LAW

We submit that, viewed <u>in</u> <u>toto</u>, the proceedings herein have failed to afford the Petitioners their minimum entitlement

^{23/} Giles v. Maryland, supra. See, particularly, concurring opinion of Mr. Justice Fortes, 17 L. Ed.2d 759.

^{24/} Cf. U.S. v. Flag, 11 U.S.C.M.A. 636, and cases cited therein



to administrative due process. The Petitioners have been the victims of a staff so steeped in its adversary role as to initially misrepresent the purpose of the private investigation and ultimately to entice the Petitioners' cooperation by the misrepresentation of the sanctions to be recommended to the Commission for the violations allegedly found. Depositions of witnesses were taken and used in the proceeding -- without notice to the parties, without an opportunity of participation of counsel, and, of course, without affording the parties the right of cross-examination. Indeed, the rules of the Respondent under which these proceedings were conducted make it a matter of the grace of the Respondent Commission to determine if a party whose deposition is taken will be afforded the privilege of obtaining a copy of his transcribed record. Finally, we submit that the so-called preponderance of the evidence standard applied as the burden of proof in the instant proceeding is inappropriate in light of the sanctions imposed and the nature of the proceedings.



(a) Staff's Adversary Role Herein Constitutes Denial of the Due Process

We respectfully submit that an administrative proceeding
"is not a game in which [staff's] function is to outwit and
25/
entrap its quarry. The pursuit is justice, not a victim."

And, yet, in the origins of this proceeding, McCoy of the staff
of the Respondent invited Petitioner Magnuson to come to Seattle
to discuss the purchase of Silver Buckle stock. There, he was
confronted with a full and complete private investigation,
which was recorded and transcribed, wholly without prior notice
that any formal proceeding was involved [R. 969]. To this
auspicious beginning, a fitting conclusion was added -- the
parties were enticed to enter into a Stipulated Statement of
Fact in lieu of a public hearing on the misrepresentation of
the severity of the sanctions sought by the staff.

We need not remind this Court of the strong economic pressures on a public broker to avoid public investigation if at all possible. But, here, the ensuing procedure did not

^{25/} Giles v. Maryland, supra.



provide the parties, rightfully, access to the investigative 26/
file. The deposition of Petitioner Magnuson was conducted
without knowledge of any prior investigation of the staff. It
is well settled that the administrative agencies, under the
27/
Administrative Procedures Act, must at least provide parties,
whose conduct is the subject of their investigation, a fair
28/
resume of the record. Thus, the courts do not view this
provision as a matter of grace within the Commission's discretion,
but rather as an essential element. Mr. Justice Clark in the
Simmons case stated bluntly that Congress, in providing for a

hearing, "did not intend for it to be conducted on the level of

a game of blindman's bluff."

^{26/} Although, in fairness to staff, in the course of drafting the Stipulation, certain files and statements were made available for review -- although copies or resumes thereof were not given out. Indeed, the Commission rules do not allow copying of private investigation orders.

^{27/ 60} Stat. 243 (1946). 5 U.S.C. §§ 1001-1011.

^{28/} Green v. McElroy, 360 U.S. 474, 79 S. Ct. 1400, 3 L. Ed.2d 1377.

^{29/} Simmons v. U. S., 348 U.S. 397, 75 S. Ct. 397.

^{30/} Simmons v. U. S., supra. at p. 405.



In this instant case, this is particularly critical for, as is established by our Petition for Amendment of the Record, there were indeed additional matters considered by the staff and the Commission which were not made known to the parties. And, the severity of the sanctions makes it self-evident that these matters adversely affected the parties' rights herein. We pray that the Court conclude that the Commission's order based on a violation of due process be reversed.

(b) The Use of Depositions Taken Without

Notice to the Parties and Without the
Opportunity of Confrontation or Cross

Examination Violates Administrative
Due Process

The record in the present proceeding includes

depositions of various witnesses received by the staff in the

course of its private investigation, as well as the deposition

of one Anthony Vaghi, taken on February 2, 1966. These depositions were taken without notice to the parties and failed to

afford the parties the opportunity of cross examination and

confrontation. The use of such material in administrative

proceedings is a deprivation of the rights of the parties to



31/

dministrative due process. When the use of such material is coupled with the inappropriate burden of proof standard, the mockery of administrative due process is complete.

(c) In Quasi-Penal Proceedings, Government
Must Meet A High Burden of Proof

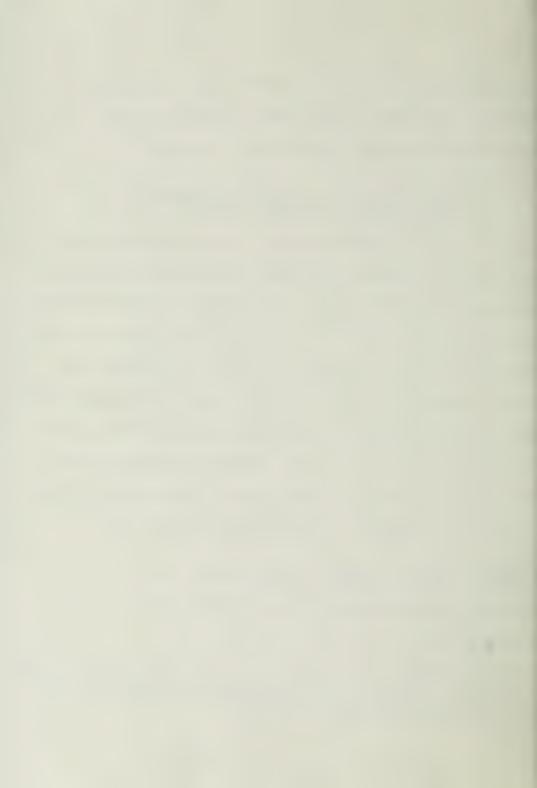
The right to hold specific, private employment and to follow a chosen profession free from unreasonable governmental interference comes within the "liberty" and "property" concepts 32/
of the Fifth Amendment. The Respondent Commission's contention that its statute, being remedial warrants a preponderance of evidence standard, is without judicial support. The Berko case relied on by the staff is inappropriate because the Court there failed to distinguish between the evidentiary standard appropriate to issue injunctive relief against a continuing or future 34/
act, and the quasi-penal punative action here involved.

^{31/} Green v. McElroy, supra. at pages 1390 - 1392.

^{32/} Green v. McElroy, supra. at pages 1388 - 1389.

^{33/} Berko v. SEC, 316 F.2d 137, 141.

^{34/} In Berko, supra., the court, as does the General Counsel here was seeking to rely on the Associated Security Corp. case (Associated Security Corp. v. SEC, 293 F.2d 738), a case involving revocation of a registration statement.



CONCLUSION

We submit that clear and convincing evidence must upport a revokation and debarment action. That support imply does not exist in the present record.

Respectfully submitted,

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Attorneys for Petitioner Magnuson

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Reply Brief of Petitioner Magnuson was mailed, postage prepaid, on this 12th day of August, 1968 to:

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William J. Kenney



UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PENNALUNA & COMPANY, INC. BENJAMIN A. HARRISON, and HARRY F. MAGNUSON,

Petitioners,

٧.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR REVIEW OF ORDER OF SECURITIES EXCHANGE COMMISSION

REPLY BRIEF OF PETITIONER MAGNUSON

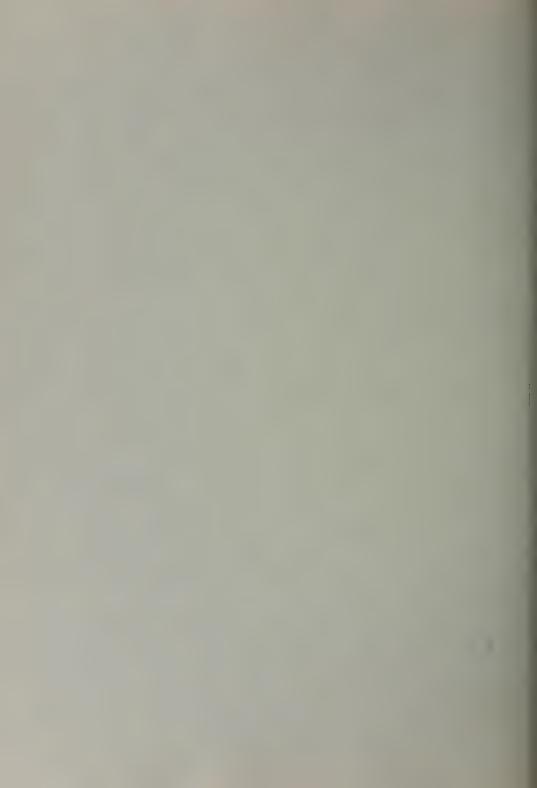
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Attorneys for Petitioner Harry F. Magnuson

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UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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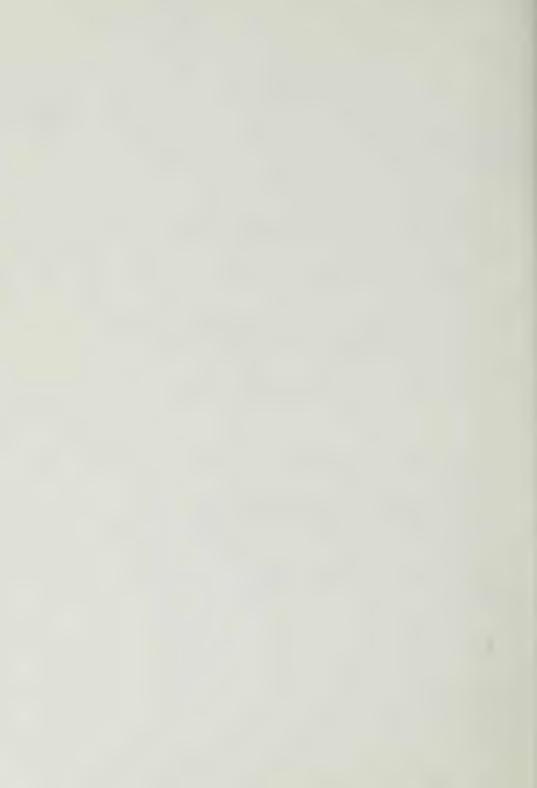


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FOR THE NINTH CIRCUIT

PENNALUNA & COMPANY, INC. BENJAMIN A. HARRISON, and HARRY F. MAGNUSON,

Petitioners,

V

No. 22143

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

REPLY BRIEF FOR PETITIONER MAGNUSON

INTRODUCTION

The General Counsel's brief for Respondent contends that substantial evidence supports the Respondent's finding that Petitioner Magnuson was a controlling person of Silver Buckle Mining Company and West Coast Engineering, Inc. throughout the period of alleged distribution; that substantial evidence supports the Respondent's finding of allegedly willful violations of the antifraud and antimanipulation provisions of the Securities laws; that the sanctions imposed were well within the discretionary authority of the Respondent Commission; and, that Petitioners' objections to the staff's conduct are untimely and without merit. Part I of this Reply shall address itself to each such contention. In addition Part II shall reply to the conclusion of the Respondent's General Counsel that the evidentiary and procedural standards were adequate in law.



PART I.

(a) Substantial Evidence Does Not Support The Commission's Finding on Questions of Control

The Statement of Facts in the instant proceeding reads as though it were an effort to redraft Genesis in the terms of the Cour D'Alene Mining District. A single incident of Petitioner Magnuson's accounting firm rendering service to Silver Buckle -- of 18 years past -- becomes the opening warp of the blanket of intrigue. Slight business and social relationships in this district of low population density becomes the framework of the story. Petitioner Magnuson's efforts to salvage the financial investment of the stockholders once he, in fact, became involved, becomes the proof. But, the Respondent has wholly ignored the problems of relevancy and reasonableness in its findings.

we shall not burden this Court with further restatement of the facts. We simply refer to the Brief of Petitioners. Dr. Scott's unrefuted testimony establishes that the group in control of Silver Buckle from the time of Petitioner Magnuson's purchase until the June, 1963 merger included Gay, the Browns, the West Coast directors and himself (Tr. 2050-2051). At any extent, even conceding, arguendo, that in fact a control relationship existed, substantial evidence does not support the contention that any ensuing breaches of the Act were willful.

^{1/} We, of course, do not so concede.



(b) Substantial Evidence Does Not Support The Commission's Finding of Allegedly Willful Violations of the Act

The Respondent Commission contends that Petitioner Magnuson was a controlling person, that his sales of stock were intentional and with knowledge of his control relationship, and, that they were, therefore, willful. These findings ignore the substantial facts of record.

The facts are that when Petitioner Magnuson purchased his Silver Buckle stock from New Park and East Utah, New Park was in possession of a legal opinion, the validity of which does not appear to be contested, holding that New Park was not a "control person" vis-a-vis Silver Buckle (Tr. 196, 2183).

This opinion was conveyed to Petitioner Magnuson at the time of his purchase of the Silver Buckle stock. Similarly, it was warranted to Petitioner Magnuson at the time of purchase, that the New Park and East Utah Silver Buckle stock were not subject to any S. E. C. restrictions (Tr. 1214, 2592). Clegg, Counsel for New Park and East Utah, and one who knew fully of Petitioner Magnuson's other interests and involvements (Tr. 197, 1185, 1197, 1215), told Petitioner Magnuson that the stock could be traded (Tr. 1215).

Finally, subsequent to the purchase of the Silver Buckle stock, Petitioner Magnuson received a legal opinion from still another source, Piatt Hull. Hull is a Wallace, Idaho attorney whose firm served as Petitioner Magnuson's personal counsel (Tr. 983), and had drafted the New Park-East Utah agreements (Tr. 1215). Petitioner's unrefuted testimony is



that he told Hull everything that was involved (Tr. 983). That opinion advised Petitioner Magnuson that he was not a person in direct or indirect control of Silver Buckle. Petitioner Magnuson himself has testified that he did not feel he could influence the management of Silver Buckle, and that he was not the controlling person at this time (Tr. 1218).

In <u>Williamson</u> v. <u>U. S.</u>, the Supreme Court held that the following jury charge adequately stated the principal governing reliance on advice of counsel:

"If a man honestly and in good faith seeks advice of a lawyer as to what he may lawfully do in the matter ... and fully and honestly lays all facts before his counsel and in good faith and honestly follows such advice, relying upon it and believing it to be correct, and only intends that his acts shall be lawful, he could not be convicted of a crime which involves willful and unlawful intent."

Similarly, under the Internal Revenue Code, the courts recognize that the word "willful" as respects offenses of willfully and knowingly attempting to defeat and evade income taxes means more than <u>intentionally</u> or <u>voluntarily</u>, and includes an evil motive, or bad purpose, so that an actual bonafide misconception of the law would justify a verdict for the defendant. It is, of course, true that legal advice does not constitute an unpregnable wall of defense, and that legal advice is a fact to be considered with other facts in

^{2/} Williamson v. <u>U. S.</u>, 207 U.S. 425, 52 L. Ed. 278, 292-93 (1908).

^{3/} U. S. v. Phillips, 217 F.2d 435, 438-41 (1955).

^{4/} Linden v. U. S., 254 F.2d 560, 568 (1958).



ever, there is no justification in the facts of this record for the Respondent Commission's contention that the counsel failed to give consideration to certain facts (Tr. 4613). In any event, the Respondent Commission failed to apply the proper standard in evaluating the effect, if any, of the reliance on advice of counsel in the present proceeding.

We submit that where, as here, Petitioner Magnuson's good faith reliance on advice of his counsel is uncontested, he cannot be found to have willfully violated the Securities Act by the sale of unregistered stock. The relief sought is the quasi-punitive action of revocation and debarment. We do not suggest that reliance on advice of counsel would defeat an action where the relief sought is truly remedial, i.e., the injunctive prohibition in the future of acts deemed in violation, or the recovery of damages incurred in the purchase of such stock; those problems simply are not involved.

(c) The Sanctions Imposed Are So Disproportionate
To The Violations Alleged and Found as to
Constitute An Abuse of Discretion on The
Part of The Respondent Commission

We urgently plead the Court to focus upon the severity of the sanctions here imposed. Wholly aside from any prior representation by the Respondent's staff as to what sanctions were deemed appropriate, the sanctions here adopted are neither reasonable nor just in the factual circumstances involved.

7/ This matter will be discussed in Section (d) hereof

^{5/ &}lt;u>U. S. v. Shaefer</u>, 299 F.2d 625, 630-31 (1962). 6/ Securities and Exchange Commission Release No. 8063, p. 3.



We do not question that the Respondent is empowered by the Congress to impose such a penalty. We submit, however, that its imposition in the factual circumstances here is a clear abuse of discretion.

For example, permanent debarment for an attorney in comparable circumstances -- first offense, previously unblemished record, a pillar of the community with a history of active support of regulatory activity -- would be untenable.

The permanent barring of an individual from the pursuit of his profession, on his first offense, is, indeed, an abuse of discretion constituting cruel and unusual punishment proscribed by the Eighth Amendment.

As noted by the Court in Gonzales v. Freeman:

"The consequences of administrative ... debarment, will vary, depending upon multiple factors: the size and prominence of a contractor; the ratio of ... (debarred) ... business to ... (non-debarred) business;.... The impact of debarment ... may be a sudden contraction of bank credit, adverse impact on market price of shares, ... and critical uneasiness of creditors generally, to say nothing of 'loss of face' in the business community. These consequences are in addition to the loss of specific profits from the business denied as a result of debarment. We need not resort to a colorful term such as 'stigma' to characterize the consequences of such governmental actions, for labels may blur the issues. But we strain no concept of judicial notice to acknowledge these basic facts of economic life."10/

^{8/} Sacher v. Association of the Bar of the City of New York, 347 U.S. 388, 74 S. Ct. 569, 98 L. Ed. 790; see also, Re Isserman, 345 U.S. 286, 73 S. Ct. 676, 97 L. Ed. 1013; debarment set aside on reh., 348 U.S. 1, 75 S. Ct. 6, 99 L. Ed. 3.

<u>9/ Weems v. U. S.</u>, 217 U.S. 349.

^{10/} Gonzales v. Freeman, 334 F.2d 570, 574.



Debarment has been characterized as "so severe that its imposition may destroy a going business, ... the power of debarment is tantamount to one of life or death over a business."

Conceding, arguendo, that such power is vested in the Respondent Commission, we turn to the question: Is it appropriate in the present case? In the Federal system, the Court of Military Appeals has established an unmatched expertise in the field of evaluating the appropriateness of a particular sanction to a particular factual pattern. In setting up the Uniform Code of Military Justice, the Congress and the President called on the best minds in the fields of criminology, penalogy, sociology, and the law. Their combined efforts find expression in Paragraph 76a of the Manual for Courts of Martial. With respect to what constitutes the appropriate sanction, it is stated:

"Normally, the maximum punishment will be reserved for an offense which is aggravated by its circumstances and the conditions surrounding its occurrence -- or a case in which there is evidence of a previous conviction involving an offense at least as serious as the one for which the accused is on trial." 12

The Court of Military Appeals, in implementing this Act, has held that "a sentence which is not fair and just

^{11/} Comp. Gen., Dec. B-139720 (Jan. 6, 1960). Unpublished letter to Secretary of Labor, quoting the Attorney General's Committee on Administrative Procedure, Division on Public Contracts.

^{12/} Manual for Courts Martial, Par. 76a (1951). The Manual is, of course, the regulations promulgated by the President for implementation of the Uniform Code of Military Justice, 10 U.S.C. 801-939.



should not be approved." $\frac{13}{}$

The military courts are not alone in recognizing that the imposition of sanctions can be the subject of abuse. It has been held that long-term imprisonment could be so disproportionate to the offense as to fall within the inhibition (Eighth Amendment prohibition against cruel and unusual punishment). And, where the record showed that the defendant was a first offender and did not indicate the case was an aggravated one, it was held that the imposition of the maximum sentence was "greater than should have been imposed."

We are, of course, left to conjecture as to what prompted the imposition of the maximum sanction in the present proceeding. Whereas, staff initially suggested settlement for a brief suspension, as the parties, and their counsel sought to assert their rights to defend themselves, the price of settlement increased. Having rejected settlement and sought a ruling of the Respondent Commission, they are now faced with permanent debarment from the pursuit of their professions. This strongly suggests that the Respondent seeks here to convey a message to those subject to its powers that it looks with disfavor on those who seek to defend themselves against the Respondent

^{13/} U.S. v. Cavallero, 36 U.S.C.M.A. 653, 654.

^{14/ &}lt;u>Hemans</u> v. <u>U. S.</u>, 163 F.2d 228, 237, 238.

^{15/} Smith v. U. S., 273 F.2d 462.



staff's accusations -- those who defend rather than submit -- will be punished.

This practice has been rightly severely critical by the courts. In <u>U.S.</u> v. <u>Wiley</u>, after noting that (as here) the defense was neither frivolous or in bad faith, the Third Circuit stated:

"Our part in the administration of federal justice requires that we reject the theory that a person may be punished because in good faith he defends himself when charged with a crime, even though his effort proves unsuccessful. It is evident that the punishment imposed by the district court on Wiley was in part for the fact that he had availed himself of his right to a trial, and only in part for the crime for which he was indicted."

We earnestly submit that judicial precedent establishes that the maximum sanction is appropriate only for the 17/we recognize that the imposition of sanctions such as debarment are an important tool in the administration of the Securities Act. But, in imposing a sanction in each particular case, the agency shifts from the quasi-administrative capacity to its quasi-judicial capacity. The courts have held that in imposing sanctions, administrative policy, per se, has no valid place, and that sanctions should not be imposed by a fixed formula, but, rather, the quantum

^{16/} U. S. v. Wiley, 278 F.2d 500, 504.

^{17/} U.S. v. Smith, supra.; U.S. v. Cavallero, supra.

^{18/} Cf. Copper Heating & Plumbing v. Campbell, 290 F.2d 368.

^{19/} U.S. v. Cavallero, supra.

^{20/} U.S. v. King, 12 U.S.C.M.A. 71, 74.



should be fixed as it is specially suited to the circumstances of the parties in each case. $\frac{21}{2}$

Assuming, arguendo, the Respondent properly found willful violations of the Securities Act, we earnestly submit that the sanctions inflicted demand revision; and that in no event is a suspension in excess of 60 days appropriate on the factual circumstances. We recognize that it is not customarily the province of this Court to re-assess sanctions imposed or sentences assessed. We, therefore, earnestly suggest that if the Court finds adequate support for the findings of violations herein, the matter be remanded to the Respondent Commission for re-evaluation of the penalties assessed in conformance with such guidance as the Court deems appropriate.

(d) Petitioners' Objections to Staff Conduct Both Timely and Meritorious

By action of the Secretary dated September 12, 1967, the Respondent Commission rejected for filing a Petition and Motion for Further Rehearing, Reconsideration and Review in this proceeding, bearing date of September 1, 1967, which was served on the Respondent Commission on September 5, 1967. That Petition and Motion, which are appended herein as Exhibit A, brought to the Respondent Commission's attention, apparently for the first time, certain allegations concerning the conduct of the staff of the Respondent in the present proceeding, and also contended that the penalties assessed herein constituted

^{21/} U.S. v. Judd, 11 U.S.C.M.A. 164, 170, Judge Fergusan's concurring opinion.



an abuse of discretion in general conformance with the arguments raised in Section (c) hereof.

The Petition and Motion in substance contended that the staff of Respondent materially misled the parties and their counsel as to the gravity with which the matter under investigation was viewed by their superiors and by the Respondent Commission. It pointed out that the parties were grossly misled as to the punitive measures deemed appropriate to the offenses which the staff considered to have been established. This attitude by the staff of the Respondent trapped and misled the parties and their counsel to accept an unduly abbreviated, Stipulated Statement of Fact, which they believed that would be all that would be placed before the Respondent Commission in the course of the procedures adopted. The Petition further contended that the staff of the Respondent, by assumption of an extreme adversary role, had reduced the proceeding to one similar to that castigated by the Supreme Court in the Giles

We earnestly suggest that the allegations raised by the Petition and Motion are of such gravity and of such a nature as to demand, in the interest of justice, consideration by the Respondent Commission. As is evident by the recent Petition for Amendment of Record herein, filed by your Petitioners, material evidence, in fact, exists to support Petitioners' contention in the above Petition and Motion that they had been affirmatively misled as to the real intentions and

case.

^{22/} Giles v. Maryland, 385 U.S. __, 17 L. Ed.2d 737.



It is earnestly suggested that where contentions of

demeanor of the staff.

this nature are raised, the interest of justice and administrative process demand their evaluation by the Commission. Accordingly, the record herein should be remanded to the Commission for further hearings on this issue. In the alternative, we urge this Court to consider the propriety of the staff's conduct of this case. In an administrative proceeding, such as the instant case, it "is not a game in which the (staff's) function is to outwit and entrap its quarry. The (staff's) pursuit is justice, not a victim." 23/ mission must insure fair consideration to all evidence in the case, and when their participation establishes a propensity to convict, regardless of matters presented, justice demands reversal of such actions. We submit that failure to comport to these standards in the instant proceedings has resulted in a proceeding which is making mockery of the Petitioner's rights to administrative due process. This shall be discussed in Part II below.

PART II.

THE PROCEEDINGS HEREIN DO NOT COMPORT WITH ADMINISTRATIVE DUE PROCESS OF LAW

We submit that, viewed <u>in toto</u>, the proceedings herein have failed to afford the Petitioners their minimum entitlement to administrative due process. The Petitioners

^{23/} Giles v. Maryland, supra. See, particularly, concurring opinion of Mr. Justice Fortas, 17 L. Ed.2d 759.

^{24/} Cf. U.S. v. Flag, 11 U.S.C.M.A. 636, and cases cited



have been the victims of a staff so steeped in its adversary role as to initially misrepresent the purpose of the private investigation and ultimately to entice the Petitioners' cooperation by the misrepresentation of the sanctions to be recommended to the Commission for the violations allegedly found. Depositions of witnesses were taken and used in the proceeding -- without notice to the parties, without an opportunity of participation of counsel, and, of course, without affording the parties the right of cross-examination. Indeed, the rules of the Respondent under which these proceedings were conducted make it a matter of the grace of the Respondent Commission to determine if a party whose deposition is taken will be afforded the privilege of obtaining a copy of his transcribed record. 24a/ Finally, we submit that the so-called preponderance of the evidence standard applied as the burden of proof in the instant proceeding is inappropriate in light of the sanctions imposed

(a) Staff's Adversary Role Herein Constitutes Denial of the Due Process

We respectfully submit that an administrative proceeding "is not a game in which (staff's) function is to outwit and entrap its quarry. The pursuit is justice, not a victim."

And, yet, in the origins of this proceeding, McCoy of the staff of the Respondent invited Petitioner Magnuson to come to Seattle to discuss the purchase of Silver Buckle stock.

and the nature of the proceedings.

²⁴a/ See S.E.C., "Rules of Practice" regs. 203.6 and 203.7, 17 CFR 203.6 and 203.7.

^{25/} Giles v. Maryland, supra.



There, he was confronted with a full and complete private investigation, which was recorded and transcribed, wholly without prior notice that any formal proceeding was involved (R. 969).

To this auspicious beginning, a fitting conclusion was added -the parties were enticed to enter into a Stipulated Statement
of Fact in lieu of a public hearing on the misrepresentation of
the severity of the sanctions sought by the staff.

We need not remind this Court of the strong economic pressures on a public broker to avoid public investigation if at all possible. But, here, the ensuing procedure did not provide the parties, rightfully, access to the investigative \frac{26}{file.} The deposition of Petitioner Magnuson was conducted without knowledge of any prior investigation of the staff. It is well settled that the administrative agencies, under the Administrative Procedures Act, must at least provide parties, whose conduct is the subject of their investigation, a fair resume of the record. Thus, the courts do not view this provision as a matter of grace within the Commission's discretion, but rather as an essential element. Mr. Justice Clark in the Simmons case stated bluntly that Congress, in providing for a hearing, "did not intend for it to be conducted on the level

^{26/} Although, in fairness to staff, in the course of drafting the Stipulation, certain files and statements were made available for review -- although copies or resumes thereof were not given out. Indeed, the Commission rules do not allow copying of private investigation orders.

^{27/ 60} Stat. 243 (1946). 5 U.S.C. Paragraphs 1001-1011.

^{28/} Green v. McElroy, 360 U.S. 474, 79 S. Ct. 1400, 3 L. Ed.2d

^{29/} Simmons v. U.S., 348 U.S. 397, 75 S. Ct. 397.



of a game of blindman's bluff."

In this instant case, this is particularly critical for, as is established by our Petition for Amendment of the Record, there were indeed additional matters considered by the staff and the Commission which were not made known to the parties. And, the severity of the sanctions makes it self-evident that these matters adversely affected the parties' rights herein. We pray that the Court conclude that the Commission's order based on a violation of due process be reversed.

(b) The Use of Depositions Taken Without Notice to the Parties and Without the Opportunity of Confrontation or Cross Examination Violates Administrative Due Process

The record in the present proceeding includes depositions of various witnesses received by the staff in the course of its private investigation, as well as the deposition of one Anthony Vaghi, taken on February 2, 1966. These depositions were taken without notice to the parties and failed to afford the parties the opportunity of cross examination and confrontation. The use of such material in administrative proceedings is a deprivation of the rights of the parties to administrative due process. When the use of such material is coupled with the inappropriate burden of proof standard, the mockery of administrative due process is complete.

^{30/} Simmons v. U. S., supra. at p. 405.

^{31/} Green v. McElroy, supra. at pages 1390 - 1392.



(c) In Quasi-Penal Proceedings, Government Must Meet A High Burden of Proof

The right to hold specific, private employment and to follow a chosen profession free from unreasonable governmental interference comes within the "liberty" and "property" concepts of the Fifth Amendment. The Respondent Commission's contention that its statute, being remedial warrants a preponderance of evidence standard, is without judicial support. The Berko case relied on by the staff is inappropriate because the Court there failed to distinguish between the evidentiary standard appropriate to issue injunctive relief against a continuing or future act, and the quasi-penal punitive action here involved.

^{32/} Green v. McElroy, supra. at pages 1388 - 1389.

^{33/} Berko v. SEC, 316 F.2d 137, 141.

^{34/} In Berko, supra., the court, as does the General Counsel here, was seeking to rely on the Associated Security Corp. case (Associated Security Corp. v. SEC, 293 F.2d 738), a case involving revocation of a registration statement.



CONCLUSION

We submit that clear and convincing evidence must support a revocation and debarment action. That support simply does not exist in the present record.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Reply Brief of Petitioner Magnuson was mailed, postage prepaid, on this 12th day of August, 1968 to:

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